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The Evolving Corporate Board

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The Evolving Corporate Board

Murray Weidenbaum

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The Evolving Corporate Board

Murray Weidenbaum

In a period of takeover battles and dramatic replacements of top managements, the role of the corporate board of directors is rapidly evolving into a major strategic force in American business.

Some companies have enacted "poison pill" provisions, which put the board of directors squarely in the middle of merger and acquisition battles. The directors adopt such a measure to discourage unwanted takeovers. The "pill" is in the form of new rights to shareholders to acquire, at a marked discount, a large equity stake in any successful suitor whose offer has not been approved by the company's board. The new activism on the part of corporate directors rose in 1993 to include replacing the chief executive officers for such industrial giants as American Express, Eastman Kodak, General Motors, and IBM.

The new burst of public attention to the corporate board, from friend and foe alike, is matched by widespread ignorance — both of how that important economic institution functions and how it has been changing in recent years. Thus, it is appropriate to examine the

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evolving role of boards of directors, with special attention to the strengthening of the board at a time when it is often the focal point of corporate response to external threats. Although I present my own viewpoint, developed in part from my service as a corporate director, much of this report draws from many studies in law, economics, and business administration.

Criticisms of the Board

Three major criticisms have been leveled at the institution of the corporate board of directors.

The Board Is a Rubber Stamp

One retired board chairman of a successful company describes the board of directors as the "Achilles heel of the American corporation."¹ A leading scholar refers to the corporate board as an "impotent legal fiction."²

The most frequently made criticism of the corporate board of directors is that it is ceremonial, rubber-stamping the views of management. This belief comes from many sources. In his 1948 classic study of large companies, R.A. Gordon concluded that directors are closer to top management than to the stockholders, and that ratification of management proposals by the board is largely a formality.³ He also reported that, as a result of its control of the proxy machinery, it is more common for management to select directors than vice versa.

Myles L. Mace, in his authoritative study of corporate boards in the late 1960s, reported that the role of directors is largely advisory and not of a decision-making nature. He quotes one company president as saying, "The board of directors serves as a sounding board. . . . The decision is not made by the board."⁴

An account of the bankruptcy of the Penn Central reached an even stronger conclusion:

Penn Central's directors seem to have done very little to earn the \$200 each received each time he attended a board meeting. . . . With few exceptions, they appeared to be blind to the on-rushing events that sent the Penn Central hurtling off the tracks.⁵

Robert H. Malott, an experienced corporate director and retired chief executive officer (CEO), identifies the biggest barrier to effective outside directorship as the "old boy" network that dominates some boards. This makes it personally unpleasant for directors to question the performance of their peers "and often their friends."⁶

The "old boy" network that dominates some boards makes it personally unpleasant for directors to question the performance of their peers.

The Board Is Dominated by the CEO

A closely related criticism is that the board's deliberations are dominated by the CEO, who typically also serves as chairman. When the same person controls the agenda and conduct of boardroom proceedings as well as the day-to-day performance of the company, the power of the individual director may indeed become attenuated. Despite the rising number of outside directors and special committees of corporate boards, in most cases the center of power remains with the management. CEOs serve as chairman of the board in 80 percent of the larger corporations.

Management consultants report that many directors act as part of top management, rather than as monitors able and willing to reward and

penalize management's performance.⁷ A longtime board member states that the ambiguity of the role of the corporate board begins with the prevailing combination of management leadership and board leadership in the same person.⁸

The Board Is Plagued with Conflicts of Interest

Corporate directors often are criticized for conflicts of interest and for showing greater concern for the welfare of other companies. Many outside directors of corporations do business with the companies on whose board they serve. The literature contains a number of cases of apparent wrongdoing on the part of outside directors who were also officers of companies that supplied services to the corporation or who benefited unfairly from company operations.⁹

An analysis of 286 banks that failed in 1990 and 1991 revealed that, in 74 cases, the main cause of the failure was fraud and other abuses by directors and officers, such as receiving loans at very low rates. In 101 other instances, insider abuses contributed to the bank's insolvency.¹⁰

In the case of the Penn Central, a staff report of the Committee on Banking and Currency of the U.S. House of Representatives censured the company's board members for their excessive involvement in other corporate boards. The Committee staff noted the subservience of many of the outside directors to the interests of the financial institutions of which they were officers. As corporate boards shift to a larger percentage of outside directors, the likelihood of such corporate "interlocks" could increase.¹¹

In the case of the larger firms, a problem is emerging in the form of opportunity for "back-scratching" when setting management compensation. The board's compensation committee is

typically a group dominated by outside directors. What's wrong with that? Frequently, those outside directors are senior officers of other firms, who are very sympathetic to motions for generous treatment of their counterparts. Aside from the intrinsic merits of the matter, their self-interest dictates such a stand. After all, the compensation committees of their own boards are often similarly composed of CEOs of peer firms. Moreover, the management consultants advising those committees take full account of such peer-group action by the other boards. The ratchet effect that results is quite obvious.

Other nominally independent outside directors, in practice, may represent another set of special interests — those of the local community. Senior officers of local firms that primarily sell goods and services to the surrounding area may see great value in the company donating lavishly to local causes, even if its markets are national or international. Another serious concern is the relationship of the inside directors to the chairman/CEO. After all, he is their day-to-day supervisor, usually with the effective authority to radically change the directors' role in the company and even to fire or demote them. It is rare to see a subordinate officer serving on a board dissent from the position taken by the CEO.

The Push for Reform

Criticisms of the board have led to a variety of proposals to reform corporate governance:

Ralph Nader's Proposals

Over the years, Ralph Nader and his colleagues have developed numerous ambitious and far-reaching proposals to restructure the corporation. To give "all stockholders in corporate decision-making a real voice in corpo-

rate governance," he advocates a Corporate Democracy Act. Under this proposal, the federal government would assume the chartering power now residing in the individual states. Nader wants to install full-time outside directors who would take an active role in the governance of the corporation.¹²

It is interesting to note that the charter of the Equitable Life Insurance Company requires the Chief Justice of New Jersey to appoint several outside directors. Over the years, these appointees have included women civic leaders and physicians, who are far from typical corporate directors. Under the Nader approach, individual directors would be assigned responsibility for specific areas of concern, such as the environment or employee relations. In his concept, federal chartering would develop a "constitutionalism" for corporate employees and provide various protections for whistle blowers who object to specific company activities. He also urges a mandatory mail plebiscite of shareholders on all "fundamental" transactions.

The intent of his reforms, according to Nader, is to address a concept of "social bankruptcy" whereby a company would be thrown into receivership if it failed to meet its "social" obligations.

The Geneen-Williams Proposals

More modest — yet quite substantial — suggestions for change in the structure of the American corporation have come from several outspoken former corporate CEOs. The two that have received most attention are Harold Geneen, retired CEO of ITT, and Harold Williams, former chairman of the Securities and Exchange Commission (SEC) and former CEO of Norton Simon. Williams contends that the ideal board of directors would include only one company officer, the chief executive. All other

board members, including the chairman, would be chosen from outside the company. Williams's concept of outside directors excludes bankers, lawyers, or anyone else having business dealings with the company. In his view, outside-dominated boards could do a better job of representing the stockholders' long-term interests than executives who are responsible for day-to-day management.

Outside-dominated boards could do a better job of representing the stockholders' long-term interests.

There is considerable precedent for an outside director chairing the board meetings. That is the standard procedure at non-profit institutions such as hospitals, museums, and universities, many of which rival in size and complexity all but the largest for-profit corporations. Also, many Western European companies normally follow this practice, as do many American companies with concentrated ownership on the part of venture capitalists and other outside investors.

Williams, unlike Nader, would not allocate individual directorships to representatives of employees, consumers, minorities, or other groups. "It would be disastrous. . . . Constituency representative . . . makes the board a political body," according to Williams. Does his proposal infringe on private property rights? The former SEC chairman states that corporations are more than economic institutions owned by shareholders: "Corporate America is too important, and perceived as too powerful, to fail to address the kinds of issues that are noneconomic."¹³

Geneen would go further than Williams, barring all members of management from serving on the board of the corporation for which they work. The CEO and other members of management would continue to attend board meetings, but they would be there to report to the board and to explain their actions.¹⁴

Other Reform Proposals

In a variation of Geneen's approach, Walter J. Salmon, of the Harvard Business School and a veteran board member, suggests that the boards of larger corporations be limited to three inside directors — the chief executive officer (CEO), the chief operating officer (COO), and the chief financial officer (CFO). As the current leaders of the corporation, the CEO and COO are there to communicate, explain, and justify strategic direction to the outside directors. Because CFOs share fiduciary responsibility with the directors for the financial conduct of the corporation, they should also have a seat on the board.¹⁵

A more modest variation on the theme of strengthening the role of the outside directors is the *Principles of Corporate Governance and Structure* proposed by the American Law Institute (ALI). The ALI proposed to replace voluntary arrangements on corporate governance, as interpreted by the courts, with legislative statutes and administrative regulations. For example, the ALI recommended that, as a matter of law, a majority of the board members of each large publicly held corporation (those with at least 2,000 shareholders and \$100 million in total assets) must be outside directors. Following substantial criticism from the business community, the ALI proposal has remained merely a basis for discussion.¹⁶

It does not seem likely that any of these sets of detailed proposals for the reform of corporate governance will be adopted on a compul-

sory basis. Yet, legislators continue to introduce proposals for legislating some of these changes. In 1993, Representative Ed Markey (D-Mass.) urged that the federal government require that all board chairmen be outside directors. He would also limit the number of boards that a director can serve on. In the United Kingdom, the Cadbury Committee on Financial Aspects of Corporate Governance has urged that non-management (outside) directors serve on only one board.

Voluntary Changes in the Boardroom

While the criticism of corporate governance continues unabated, important changes in the boardroom are being made on a voluntary basis. These adaptive adjustments have resulted from significant shifts in the environment in which corporations and their boards function. First is increased government regulation and the threat of further intervention. The second influence is active concern with corporate governance by some large institutional investors (especially state and local government employee pension funds). Other factors include greater foreign competition, rising levels of litigation by shareholders, and criticism from the press. In part, these changes deflect or reduce the pressures for new statutes or regulations requiring compulsory modifications in corporate governance. Also, the increased liability of corporate directors for their actions is reinforcing the trend toward their greater involvement in company decision-making.

According to the head of a major consulting firm, "Passive ceremonial directors are fast becoming an endangered species."¹⁷ A survey of the boards of directors of large U.S. corporations concluded that "the days of the 'rubber stamp' board are over."¹⁸ Clearly, many boards are taking on a more active role.

Eight Basic Changes

Eight basic voluntary changes in the boardroom can be identified:

1. Outside directors have become a majority of most boards of large companies in the United States, and the move toward more outside directors continues. In 1938, only one-half of industrial corporations had majorities of outsiders on their boards. By 1992, the average corporate board had nine outside directors and three inside directors. Also, board size has declined somewhat, reflecting in part the reduced role of inside directors. In 1992, the typical board had 14 directors, down from 16 in 1982.

Some movement is also being made voluntarily toward the Geneen-Williams view on board composition. Of the 100 large corporations analyzed in 1992 by the executive search firm Spencer Stuart, eleven were comprised entirely of outside directors except for the chairman/CEO. In 1987, this condition was true in only 3 of the 100 firms. Simultaneously, the prevalence of "dependent" outside directors (those who also provide services to the company) has diminished. In the 1970s, the average board included a commercial banker and/or an attorney. That is true in only a small minority of instances in the 1990s.¹⁹

2. A broader diversity of backgrounds is evident in the type of persons serving on corporate boards. Increased numbers of directors have public service, academic, and scientific experience. Boards also include rising percentages of women and minorities. A survey of top company board placements in 1992 indicated that approximately 30 percent were women or blacks.²⁰ During the same period, the percentage of boards with ethnic minority members rose from 11 percent to 26 percent, those with academics from 36 percent to 52 percent, and those with former government officials from 12 percent to 31 percent.

Another trend in the composition of U.S. boards of directors is the rising number of directors from other countries. In 1992, 22 of the 100 large corporations surveyed by Spencer Stuart had a total of 27 international outside directors.

A survey of top company board placements in 1992 indicated that approximately 30 percent were women or blacks.

3. Auditing committees have become a nearly universal phenomenon. Typically, these financial oversight bodies are composed entirely of independent outside directors (an absolute requirement for firms listed on the New York Stock Exchange). The audit committees have direct access to both outside and inside auditors and usually review the financial aspects of company operations in great detail. As recently as 1973, only one-half of large U.S. corporations had auditing committees. Currently, the proportion is 99 percent.

4. In many companies, nominating committees propose both candidates for the board and senior officers. These committees usually have a strong majority of outside directors (typically, four out of five). However, these statistics do little to illuminate the continuing powerful role of the CEO in initiating or approving committee selections. In practice, most outside directors are selected by the chairman/CEO and in virtually all cases, he or she must be agreeable to their appointment.

5. In most large companies, compensation committees evaluate the performance of top executives and determine the terms and conditions of their employment. These

committees are composed largely or entirely of outside directors. In practice, many of these committees rely extensively on outside consultants whose compensation surveys often set the framework for committee deliberations.

6. On average, about one out of five of the larger companies have established public-policy committees on their boards. These committees give board-level attention to company policies and performance on subjects of special public concern. Topics with which public-policy committees often deal include affirmative action and equal employment opportunity, employee health and safety, company impact on the environment, corporate political activities, consumer affairs, and ethics.

Pfizer, the large pharmaceutical firm, has appointed a new vice president for corporate governance. The company's expectation is that this officer will be proactive in responding to legislation and regulations in the field of corporate governance and will advise the top management on the latest thinking on corporate structure and shareholder relations.²¹

7. Internal management and accounting control systems have been strengthened. In part, the impetus has come from the need to comply with the provisions of the Foreign Corrupt Practices Act. The activities of the audit committees surely are a reinforcing factor. As a result, the flow of information to board members has been upgraded and expanded.

8. Recruiting directors has become more difficult. Increasing the role and the remuneration of directors have helped make board service more attractive. However, these positive factors are on occasion offset by a change in the narrow, technical area of directors' liability insurance. In recent years, courts have narrowed the scope of the business judgment rule, which provides board discretion to board members in carrying out their functions. The

resultant acceleration of lawsuits against corporate boards has increased the costs of the insurance companies that have previously covered the bulk of such expenses. In turn, this has led to a marked decline in the willingness of carriers to write directors' and officers' liability insurance policies. As a consequence, some directors have reduced the number of boards on which they serve in order to concentrate on their responsibilities on the remaining boards.

Boards have traditionally responded strongly when corporations have faced real crises.

Boards have traditionally responded strongly when corporations have faced real crises. In the early 1990s, outside directors began taking a more active stance in reacting to poor performance on the part of the managements reporting to them and thus to avoid the development of crisis situations. In 1992, the General Motors board, led by outside directors, replaced the CEO and designated an outside director (a recently retired CEO of another major enterprise) as nonexecutive chairman.

In 1993, IBM, after replacing its CEO, created a new committee of outside directors to focus on corporate governance. The function of the new committee is to nominate new directors, handle proposals from shareholders, and oversee the functioning of the board. In the same year, Eastman Kodak replaced its CEO and formed a corporate directors committee of outside directors to oversee its basic strategy.

An important and voluntary institutional change occurred in 1994 when the board of di-

rectors of General Motors issued 28 "guidelines on significant corporate governance issues." The GM guidelines formalize the stronger control over management that the board had moved to in 1992. Specifics include designating a "lead" outside director to chair three meetings of independent directors a year, giving the board rather than the CEO real authority to select new members, and a new director affairs committee. The duties of that new committee include assigning members to board committees and evaluating the board's performance each year.²²

Labor Empowerment on the Board

As a result of the financial difficulties encountered by many companies during the 1980s and early 1990s, some labor unions were given the authority to designate one or more members of the firm's board of directors as part of an overall package that contained reductions from customary wage increases and often outright cuts in labor compensation. In 1980, Chrysler Corporation became the first major company in the United States to elect a union leader to its board. That was done in connection with a package of union concessions to help the company to continue operating during a very difficult period.

In 1983, the Teamsters Union agreed to a substantial lowering of wage and benefit levels at Commercial Lovelace Motor Freight, Inc., a company hard hit by competition from nonunion truckers. In return, workers were given just over 50 percent of the stock and the right to elect three of the seven members of the board. At five other trucking firms, the Union agreed to a similar package, but worker ownership was kept to less than 50 percent. In some instances, the union-designated board members have been retired executives from business and government, avoiding conflicts of interest.

In 1993, several steel companies — Bethlehem, Wheeling-Pittsburgh, and LTV — agreed to having a representative of the United Steelworkers Union serve on their boards. At about the same time, Northwest Airlines and TWA both agreed to give their employees a major share of the corporation's ownership. As part of a move out of bankruptcy, TWA gave its employees a 45 percent ownership of the company plus four board seats. Northwest provided three board seats plus 37.5 percent of the company's stock. Both airlines received several hundred million dollars of concessions in labor costs.

Union memberships on corporate boards are still isolated examples, and the entire subject remains extremely controversial. Although the concept of employee representation on the board is common in Western Europe, it is not a generally accepted notion in the United States. In Germany, codetermination laws have required worker representation on the boards of larger companies since 1951. However, that nation has a long tradition of labor-management cooperation. The fact that German worker compensation averages higher than other industrialized nations is not an inducement to U.S. firms to copy the example.

Such actions, although few, provide a powerful signal to top management that inadequate performance can result in their replacement by a hitherto supportive board of directors. It is especially noteworthy that these changes in management did not require a formal takeover ("change of control") with its ancillary legion of expensive investment bankers, attorneys, and accountants.

Strengthening the Board

Despite the progress that has been made in recent years, most writers on the role of the

corporate board reach some variation of the same dual conclusion: the board of directors is a vital part of the business firm, but it often does an inadequate job of carrying out its responsibility to represent the shareholders.

The result can be a policy vacuum, which provides opportunity for those outside of the corporation. Dramatic moves have been made to take advantage of the fundamental shortcoming of corporate boards. These responses have come from the so-called predatory raiders who attempt to take advantage of the latent support of shareholders for changes in the status quo.

Predatory raiders take advantage of the latent support of shareholders for changes in the status quo.

Of course, corporate managements view this phenomenon differently. A spokesman for the Business Roundtable describes the strategy of "professional raiders" as waging "blitzkrieg warfare" devised to "outflank the corporate board of directors and stampede the stockholders."²³ There is no need to glamorize the activities or the motives of the raiders while noting the positive contributions they make. One of the most successful takeover specialists describes his efforts as "acting in pursuit of personal financial gain and not out of altruism . . . I do it to make money."

Recommendations

The following suggestions are offered in the spirit of strengthening the corporate board without setting up a mechanism competitive with the company management:

We must recognize the extent to which takeover battles have occurred because of the cumulative inaction of some boards of directors. It is easy enough to denounce financial entrepreneurs who have little interest in the production of goods and services, but who profit — often in the form of "greenmail" — merely from making unsolicited takeover bids. But if they are opportunists, we must ask whether existing board and management practices have created these opportunities. A clue is given, perhaps inadvertently, by the Roundtable's lament that a successful corporate defense may involve drastic restructuring to maximize share value in the short run. Without endorsing the desirability of such a change, we can wonder whether it does reflect the true desires of many shareholders who indeed want to maximize share value in the short run.

Despite their attraction to defending managements, legislative proposals to make unfriendly takeovers more difficult do not deal with the fundamental need to respond to the desires of the shareholders. That is both the basic responsibility of the board and the key to its potential power. Corporate officials, both board members and officers, may forget that shareholders continually vote with their dollars. The less frequently key issues are presented to the shareholders, the more likely they are to resort to their ultimate weapon — selling their holdings in a company whose policies they disagree with.

Observe that some of the problems of the takeover targets may have arisen from the desire to be more socially responsible. Examples include Cummins Engine and Control Data Corporation, both of which suffered under management with an unusual interest in broad social problems. Much of the modern management literature refers to the need for top management to balance the desires of employ-

ees, customers, suppliers, public-interest groups, and shareholders. For example, the Committee for Economic Development, in its widely circulated report on the social responsibility of business, stated that the modern professional manager is regarded as a trustee balancing the interests of many diverse participants and constituents in the enterprise (shareholders are only listed as one among many worthy groups).

The chief executive of a large corporation has the problem of reconciling the demands of employees for more wages and improved benefit plans, customers for lower prices and greater values, vendors for higher prices, government for more taxes, stockholders for higher dividends and greater capital appreciation.²⁴

In the case of Control Data, after an annual loss of \$680 million, a new CEO replaced his predecessor who had stressed corporate social responsibility. The new CEO bluntly stated that the previous management had not always "thought in terms of building shareholder value" and had not built a culture of controlling costs.²⁵

The heart of a positive response to the dissatisfaction with corporate performance is for directors to act more fully as fiduciaries of the shareholders, as the law requires. The same authorities who are almost universally critical of the way in which corporate boards operate are unanimous in their belief that a well-functioning governing board is essential to the future of the modern corporation. Virtually no one has concluded that the board of directors has outlived its usefulness. Even such business critics as Ralph Nader would lodge majority responsibility for governing the corporation in a revitalized board of directors.

The most fundamental need in corporate governance is educational — get senior corporate officers to understand their high stake in enhancing the role of the board of directors. There would be fewer challenges to the existing managements of their companies if more boards acted from a day-to-day concern with the interests of their shareholders. The benefits of a more active board will not be attained without costs. Achieving a stronger and more effective board means sharing the authority now lodged in the CEO — and at times reaching somewhat different decisions. But that does not require the establishment of a competitive power center. It does mean being more conscious of the desires of shareholders, and of the need to keep them more fully informed. Only one person — the chief executive — can guide the corporation's day-to-day activities. That function cannot be performed by a committee.

Achieving a stronger and more effective board means sharing the authority now lodged in the CEO.

Successful directors learn to monitor and question while creating an atmosphere of confidence in the management. Simultaneously, a truly secure CEO will not attempt to stifle criticism by individual directors. The legendary Alfred P. Sloan reportedly made the following statement at a General Motors board meeting:

Gentlemen, I take it we are all in complete agreement on the decision here. . . . Then I propose we postpone further discussion of

this matter until our next meeting to give ourselves time to develop disagreement and perhaps gain some understanding of what the decision is all about.²⁶

What about the composition of the board? Experience teaches us to be leery of simple solutions. An example is the popular proposition that only outside directors should serve on a corporate board, with the possible exception of the CEO. Diversity of talent is a strength in the management of an economic organization.

Retired officers of a company do not belong on its board. It is enough to have independent outside directors looking over the shoulders of the management, without the previous generation of management also doing so. The outsiders have less stake in defending the status quo than do the retirees who may have created existing conditions. There are advantages in retired corporate officers serving as directors of other companies, so long as they are not competitors of or suppliers to the company from which they have retired.

Corporate boards should consist primarily of independent outsiders. Outside directors should not represent banks, law firms, customers, or the community in which the corporation happens to have its headquarters. Such actual or potential conflicts of interest should be avoided. *A strong but minority representation of knowledgeable insiders should continue.* Nominating committees would do well to bear in mind the advice of management scholar S. Prakash Sethi that a board of directors is not a debating society: "While it is normal to have different viewpoints and expertise represented on the board, it is illogical to represent special interests on the board."²⁷

Opinions differ sharply on whether the CEO should also serve as chairman of the board. *In my personal view, the board chairman should*

usually be an outside director in order to assure the independence of the board. Much depends on the attitude of the CEO to the board and to the specific challenges facing the company. There is no compelling need to modify the traditional arrangement in the case of a well-functioning company whose CEO also maintains an open, healthy relation with the board. In such circumstances, it would be silly to change merely for the sake of change.

However, when the company is not performing well or when the CEO regards the board as merely a legal necessity, then a departure from the status quo is warranted. Under such circumstances, it would be helpful if the presiding officer had relevant experience — the recently retired CEO of another firm or of a large non-profit institution, for instance. A few other senior members of the management also can be useful board members. The chief operating officer would be appropriate. His or her presence on the board does not give rise to the problems that occur when operating officials are made board members — when they participate in reviewing their own operations and those of their colleagues. Because of the crucial relationship of financial reporting to the monitoring function, the chief financial officer probably also should be a board member. None of these inside directors can be expected to differ frequently with the CEO, thus emphasizing the need for a substantial representation of outside, independent directors.

Where the board chairmanship is filled by an outside director, the position should be a private role whereas the CEO should represent the firm to the public. Only the CEO and his or her subordinates can truly represent the firm in public arenas since they bear the responsibility and possess the authority to conduct the business of the company. This approach requires a high degree of good will on the part of

both outside directors and corporate officers. The indispensable factor in ensuring an effective board is that directors and management be committed to making the board work. A great deal of effort and discretion is required on the part of outside directors to carry on an active and constructive role that is simultaneously probing and supportive.

The indispensable factor is that directors and management be committed to making the board work.

The points just made for board service apply with equal force to committee work. Compared to board meetings, directors are more likely to take the initiative in committees. Some institutional protections of the independence of board committees are necessary and are now often in place. Specifically, the audit committee — even if the corporation is not listed on the New York Stock Exchange — should consist entirely of independent outside directors. The compensation committee, which passes on the pay and fringe benefits of top management, should be similarly constituted. Also, the nominating committee, with a key role in selecting directors and senior executives, should be comprised of independent outside members.

In contrast, the finance and public-policy committees can benefit from a balance between insiders and outsiders. The management directors bring a special institutional knowledge, while the outside directors hopefully operate with a wider framework. Another reason for the mixed finance committee is that

it provides a built-in opportunity to balance the pressures for dividends and retained earnings. Often many shareholders emphasize the short-run benefits of increased income, whereas management is more concerned about investing in the company's future growth. Also, the officers may simply find it easier or at least more satisfactory to use retained earnings rather than going to the credit markets. For the typical business firm, this is not an either-or choice, but a case of balancing two important and basic considerations.

The subject of board turnover is often a painful matter. A directorship is not a type of civil-service appointment, but it is not easy to dislodge a long-term director. Long-time directors become so accustomed to the existing way of doing business that they viscerally oppose innovation on the oldest bureaucratic grounds: "We have never done it that way."

CEOs and other busy professionals are rationing more carefully than in the past the number of boards on which they serve. Likewise, boards are more selective in their new appointments. Outside directors should be truly independent. They should not also simultaneously be paid consultants or advisors to the management. They should not have their own interests in mind, be it supporting the local community or advocating more generous treatment of corporate executives generally. Outside directors need to bear in mind that, in a very special way, the future of the corporation is in their hands — so long as they serve the desires of the shareholders.

A Look to the Future

A growing array of external forces impinges on the contemporary corporation. Some of these factors are financial and economic, focus-

ing on the traditional functions of business enterprise. Others are social and political, dealing with business responses to other issues. Together, these influences will likely produce significant further changes in the composition of corporate boards of directors to increase the active involvement of corporate directors in the decisionmaking of the business firm.

A growing array of external forces will likely produce significant further changes in the composition of corporate boards of directors.

Looking ahead, researchers and practitioners alike in the twenty-first century will probably still be speculating about the needed changes in the roles and activities of corporate directors. Fundamentally, this will reflect the fact that the corporation is a continually evolving institution in the U.S. economy and, as external requirements change, key elements such as the board of directors continue to adapt and modify their actions. These factors help to explain the fundamental strength and long-term resiliency of private enterprise institutions in the United States.

Notes

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