

An Orientation for New Directors

April 14, 2010

Posted By Directorship Editors

A spirited group of outstanding directors and corporate governance professionals convened at NYSE Euronext to discuss how companies and their boards are developing fresh approaches to help orient new directors. The methods range from the early-stage specification of a search to properly integrating with the management team, to learning the subtleties of a company's culture and character. *NACD*



LEFT TO RIGHT: Catherine L. Bromilow, Norman R. Augustine, and John F. Morrow

Directorship chairman and editorial director, Jeffrey M. Cunningham, moderated the discussion.

^[1] ***NACD Directorship:*** *Has the boardroom of 2010 undergone a sea change?*

Noski: Yes and maybe no. I think we have the Sarbanes-Oxley compliance aspect nailed down. We spend a great deal of time with strategy and succession. If a business isn't in duress, the board's work is fairly straightforward. But if you pick the wrong CEO, you have just wasted the next five years because it takes a few years to assess and terminate the current CEO and then a few years for a successor to get up to speed. So to me, succession is a key skill and a critical responsibility that is sometimes overlooked in the regulatory frenzy.

NACD Directorship: *What are some of the challenges for new directors?*

Bromilow: I have seen new directors struggle in some areas. It's important for directors to understand the culture. Different companies operate in very different ways, so understanding how to work within that framework is important. To the extent the company is in a unique industry, it may also be a challenge to understand the business model and the special risks. New directors should also understand how the board approaches its oversight role.

^[6] For directors new to the audit committee, there is an additional layer of challenge. Financial reporting is complex and audit committee members should understand how the company deals with it. It includes understanding how financial information rolls up, the key players in the finance function and the applicable regulatory and compliance matters.



Scott R. Cutler (l) and Charles H. Noski (r)

NACD Directorship: Pfizer is a leader in corporate governance, how do you orient new directors?

Kenney: Pfizer has a very robust director orientation process with scheduled meetings with each of our division heads and other senior leaders over the course of six to nine months. We give directors a significant amount of information to contact any member of senior management, including the controller and treasurer. We provide not only office contact information but also their home contact information. This is management's way of saying to our directors, "We have confidence that you can go directly to any of these people with questions."

NACD Directorship: Norm, suggestions for the new director?

Augustine: When I served on one board, we had a board dinner the night before each meeting. At every dinner we would assign one member to talk about his or her life. It changed the tone of the board and its effectiveness. We all looked at each other quite differently when we knew more about each other. It helped us work together much more effectively.

NACD Directorship: How much time do directors now need to devote to board duty?

Kopelman: The surveys indicate this has increased significantly over the last decade, but recently leveled off. Trying to overlay upwards of 175 hours of annual board service—including review and preparation, travel, board and committee meetings, plus informal calls and emails on top of a full-time staff or line job is surely a challenge both for the executive and his or her employer. Recently retired, seasoned executives seem to be able to get up to speed quickly and devote the ongoing time.



Stuart R. Levine

NACD Directorship: Are there specific skills for new directors?

Levine: Independent judgment. The proxy rules from December 16 now require for the first time that boards explain their selection criteria philosophy. For me, that is key—does that person have the ability to have a challenging discussion without becoming too personal? Directors need to keep their cool but also know when to strike it hot. I would also add that they should have a burning curiosity about the important things. It's important to understand their individual potential contribution as well as how they will impact on the creation of meaningful board dialogue.

Barry: Boards look for specific skills in new directors that may be currently lacking—which can reflect the sector or the company's condition at the time. So while the specific skills being sought will differ from company to company, there are skills and attributes that are important for all directors. First, directors should bring broad business experience and an appreciation for contemporary management techniques and

leading practices. Second, directors need to demonstrate leadership. This encompasses strategic thinking and planning, decision making, negotiation and problem solving. They also must have the courage to ask tough questions and to probe management when they are uneasy. Third, it's important for directors to have insight, judgment, integrity and a sound professional demeanor—to disagree without being disagreeable.

NACD Directorship: *Should “on-boarding” be a formal process? What special recommendations would you have?*

Noski: What I ended up doing was to design my own onboarding. Once I understood the organization, I would advise the CEO or lead director that these are the people that I want to go and spend time with. My early experience was largely trial and error. Now, I work with the board chair or lead director and we have designed a program for incoming directors. Another novel approach is to have a policy of not assigning new directors to serve on committees in their first year.

Bromilow: Boards don't turn over that quickly, so companies often have an ad hoc onboarding program. Director candidates should conduct due diligence before accepting any nominations, so they will already have some insight into the company. But that doesn't preclude the need for proper orientation, which should include, at a minimum: the company's strategic plan; a discussion about the key risks the company faces, how it mitigates those risks and the board's role in risk oversight; and an introduction to the management team and an understanding of the succession plan.

From PwC's perspective, audit committee orientation for new members should start with a discussion of financial reporting, including areas of key judgment. Then it should introduce the key players from finance, internal audit and the external audit team. It should also cover how the audit committee discharges its other core responsibilities over areas like compliance.

Kopelman: We have to make a distinction between folks who have never sat on a public board before and those who have a couple of directorships under their belt. You need to make sure that new directors get a grounding in governance—that they thoroughly understand the board's role and especially how it differs from management's, both legally and practically. I have seen an informal buddy system—assigning a sitting director to each newcomer—work well. Also, I'm involved with onboarding directors for companies coming out of Chapter 11: You're parachuting people in who need to start functioning as a team. It will take time for them to gel and function effectively as a group—just look at the Yankees over the last eight years!

NACD Directorship: *Norm, what have you seen that works?*

Augustine: The best example I can think of comes from Procter & Gamble. As the board would travel to various parts of the world, P&G would arrange for us to visit people in their homes and sit down with real customers—housewives, children and families. We'd ask them about Tide—why don't you buy Tide? In one case, the reason was that when the housewife had to buy soap she had to walk a considerable distance home with a huge box—so she wanted small packages even if they were less economical. The result was Tide produced and sold in smaller boxes. You can't merely have the corporate staff tell you what the business is about you have to get out and see it.

NACD Directorship: *Scott and Glenn, do you or the NYSE have a view to share?*

Cutler: I agree that relationships with management, service providers and customers are extremely important for directors, as is having an understanding of governance. But more than ever, corporate boards have to focus on the company's stock, its shareholders and what influences their decision-making. There aren't enough boards that have an active dialogue with shareholders, and boards ought to think more about that.

Tyranski: What does the investing public think? Investors are really counting on boards to reach out and meet with the right person beforehand and ask the right questions.

NACD Directorship: *John, in terms of understanding risk, what extra measures should the audit committee be taking?*

Morrow: I can't overstate the importance for audit committee members to get to know the people in the finance function, including the CFO, controller and other significant players. There is so much that can go wrong within the finance function—so much opportunity for fraud and malfeasance—that audit committee members should get to know the character and integrity of individuals in key finance function roles.

NACD Directorship: *What about new directors and that highest profile of subjects, compensation?*

Ferracone: The compensation committee is certainly where the accountability resides, and the workload has increased due to added regulation and scrutiny. The board members on the compensation committee really do need some structured training. It is often said that many board directors have skills from their careers that are quite relevant but ironically, few have experience with executive compensation. So at Fariant, our orientation begins with the framework that provides the new director with a strong but basic background—looking first at a detailed view of the external landscape. We then also capture the compensation history in the company, its peer group, its pay philosophy, its plan designs, as well as internal issues. We then take new compensation committee members through the alphabet soup of technical items: 162(m), 280G, 409A, SEC disclosure rules and long-term incentive valuation models.

Our overarching goal in this exercise is to train the new director to be on the lookout for program design features and scenarios that develop into outliers. Finally, with respect to performance and pay alignment, we show how to test to what extent their company's performance and pay are aligned.

NACD Directorship: *What are some of the smart compensation practices you have seen?*

Augustine: The first question many people outside the corporate world ask is whether the CEO for this or that company is worth 250 times the wage of the lowest paid worker. That may seem like quite a disparity. But take the experience at P&G where A.G. Lafley led an effort that rewarded shareholders with billions of dollars in what was essentially a "turnaround." What was he and his team worth to a shareholder?

I'm a believer in pay for performance, but that is not always so simple. What if companies perform poorly, not because of CEO performance but because of a poor economy? Should the CEO and management then be penalized? When things are going badly management is not enjoying life; the job is much more arduous—dealing with constituencies that are quite unforgiving. This is the last time one would want to risk losing a good CEO. But if we pay generously when things go up, do we not cut pay when things are in decline? It is also noteworthy that in the military they give medals for bravery in retreats, too.

NACD Directorship: *Norm, it is nuanced as you say, but we have to deal with it. Any suggestions?*

Augustine: Many of the issues around compensation can be resolved through a few smarter practices. "Holding periods" are an example. I strongly believe management should hold the stock resulting from the exercise of options, after selling the necessary amount to pay taxes, for at least three years. I also favor certain clawback provisions, which can be an excellent reminder of the need for long-term performance. Whatever the case, judgment is crucial; don't trap yourself with formulas alone.

Gershkowitz: The most important issue we are helping clients to address is how to truly ensure that pay is aligned with performance. Virtually every company makes this claim but we now know that it is much harder to achieve than one thinks. Fariant has developed a visual representation of alignment that is underpinned by a quantitative model that we use with compensation committees to take a snapshot of their current degree of alignment relative to the broad market, their industry and even a specific peer group.

We also work with committees to run different scenarios to see how it might be possible to improve alignment by introducing new programs or redesigning some features of current programs. For example, using a fixed-share approach to stock option awards will have a different impact on alignment going forward than a value-based approach.

Similarly, a performance-share plan will have a different impact on alignment than a stock option or restricted stock plan. In the current environment, the ability to determine where a company stands in terms of pay and performance alignment and model out future scenarios before approving new plans,

plan changes or plan exceptions can be a powerful decision-making and governance tool for compensation committees.

The Boardroom Guide for the New Director Advisory Council

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