

#36 The Evolution of the Lead Director

*Boardroom Consultants, a leading firm specializing in governance consulting, succession planning, CEO search and director selection, recently held its thirty-sixth roundtable on issues facing boards. **Bob Weissman**, a member of our Advisory Board and a distinguished director and former chairman/CEO of Dun & Bradstreet and IMS Health, led a group of corporate directors in a discussion about the current role of and future implications for the lead director. Mr. Weissman, a member of the board of Cognizant Technology Solutions and a trustee of Babson College, is also the lead director at State Street Corporation and the presiding director at Pitney Bowes Inc.*

HIGHLIGHTS FROM THE DISCUSSION

A Role Born Out of Crisis

The title may have been born out of crisis but today directors view the trend toward lead directorship as a permanent one rather than simply a fad. More than 90 percent of S&P 500 company boards have created a lead director or equivalent role compared to 30 percent in 1999. Clearly, the corporate disasters of Enron and Worldcom have influenced this dramatic increase which has also been spurred, in the post-Sarbanes era, by NYSE and NASDAQ requirements that there be regularly scheduled meetings of a board's independent directors. But we have to go back even further – to 1992 – to find its beginnings. Explains discussion leader Bob Weissman, “What happened at GM, when the independent directors came together in an ad hoc meeting in a New Jersey hotel to discuss their concerns about the then CEO's performance, was a seminal moment in creating credence for the value of the lead director.”

Best practices for the job have not yet been fully defined. As such, the lead director role has the potential to improve the process of governance or degrade it.

“As directors, we have an obligation to shape the lead director role so that it contributes to the quality of corporate governance.”

Principal Responsibilities

At a minimum, the lead director presides as a moderator at the meeting of the independent directors. That has led many boards to use the title ‘presiding director’ in place of lead director. Although this implies a more limited role, most directors use those two titles interchangeably. There is a third alternative, which is appointing a non-

executive chairman. But because of the importance of that title, the emotional freight it carries with most CEOs and the often additional responsibilities associated with that role, we see a lower incidence of that here in the U.S.

Regardless of what moniker the board chooses, most directors agree that the lead director should be charged with:

- Organizing the board's evaluation of the CEO.
- Providing continuing, ongoing feedback to management from the board's executive sessions.
- Assisting the CEO with setting board meeting agenda.
- Leading the board in anticipating and responding to crises.

On a broader note, Bob Weissman describes a critical role of the lead director as making sure the board is “flying at the right altitude.” As he explains, “It's awful easy to cross the line...to fly at too low an altitude and move from being an advisor providing oversight to deciding as an independent director that you ought to co-own management decisions. An effective lead director needs to prevent this from happening because then the entire governing system is at risk.”

“Of all the things mentioned, flying at the right altitude is the one I tend to need to address myself because the ceiling varies depending on whether it's a clear day or a cloudy one.”

A board can also diverge from key issues into irrelevant ones so it is the obligation of the lead director to remain focused on the areas that are the board's primary responsibilities – namely: the development and succession of management; oversight; operational performance review; strategy development and enterprise risk management.

Formally Defining the Role

There are various other tasks that can be assigned the lead director. For example, in the case of a smaller company or at a company where the CEO is young and untested, the lead director could function as a more active mentor to management. The lead director may also be called upon to step up in troubled times, possibly even as interim CEO until a competent successor can be found as we've seen recently at Computer Associates, Wendy's International, International Flavors & Fragrances and Guidant Corp.

The bottom line is that the role of lead director can be defined as anything the board wishes it to be. Preparing a written description can be helpful. If for nothing else, as a starting point for dialogue among the independent directors that can lead to consensus. For many lead directors, it is helpful to know how fellow directors define the boundaries of the role in order to avoid overstepping them.

Appointing a Lead Director

Before naming a lead director, the independent directors must decide upon a method of selection. There are many different possible variations and selection methods to choose from. Some companies default to the most senior director in terms of service on the board to be lead director. Others have the Governance Committee select one. Still others rotate the role among committee chairs or all independent directors on an annual basis. One participant strongly encouraged boards to choose a lead director only on the basis of merit since not every director will have the natural skills needed to be highly effective in the role. "Anecdotally," he argued, "I have only heard of three instances where a new lead director has not worked out and in each case that person was selected on the basis of seniority rather than ability." That's kitchen research but it has a message.

Key Factors in Success

One of the key factors in having a successful lead director is the relationship between a lead director and the CEO. There must be mutual respect between them otherwise it's just not going to work. Also, the lead director needs to encourage and facilitate communication with the rest of the board. As one participant reasoned, "Just because you're the lead

director doesn't mean that you should be the only director communicating with the CEO. Every director should have open dialogue with management. You don't want to block communication, you want to encourage it and facilitate it. As lead director, you have to encourage all of your directors even those with a dissenting opinion."

Potential Adverse Consequences

One potential adverse consequence of having a strong lead director is this inclination on the part of other directors to reduce their level of engagement, thinking everything is all right or incorrectly assuming that any communication must go through the lead director and that it is inappropriate for them to speak individually with management. This kind of environment has some very real dangers. As one participant put it, "If we're not careful, we can wind up with directors becoming potted plants again."

“What the lead director role and all the other corporate governance initiatives are geared up to do is ensure that independent, dissenting views are given sufficient consideration.”

Collegiality is an issue for the whole board. Directors have been psychologically brought up with the notion that consensus is the thing. If one looks at the details of the most recent governance disasters, one can see that the dissenting view was never encouraged, recognized or propagated. The biggest challenge of the lead director role may be in finding the balance between consensus and dissenting views.

One way to limit the potential negative effect of a strong lead director whose presence may muffle the other directors is to make sure the role is rotated on a regular basis. There is a downside to a lead director staying in place for too long and becoming too cozy in his or her relationship with the CEO and with fellow board members. This happens, too, with non-executive chairs who tend to lose their independence over time. Anyone in the role of lead director needs to be thinking about how to be appropriately close but not too close and when to step back and let someone else in.

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