

Reforming Corporate Governance: The Board

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The fanfare surrounding the President's signing of new corporate accountability legislation last week was quickly and unceremoniously replaced by more bad news from Wall Street and new worries about the economy. A lead story in last Sunday's *New York Times*, for example, reported that foreign direct investments in the U.S. last year fell to \$126 billion from a high of \$301 billion in 2000, and started this year at an even slower pace. On Monday, the International Monetary Fund cautioned that, while it expects the U.S. recovery from last year's recession to continue, the stock market fall-off and loss of investor confidence because of corporate accounting scandals have increased the country's economic risks. The IMF urged policy makers to keep budget deficits under control and—Listen up now!—consider rolling back some of the scheduled tax cuts passed in 2001.

Whether or not the new federal accountability law will help investors regain needed confidence in corporate management remains to be seen. One critic of the new law, Barbara Langer, writing in *Utne Reader Online*, describes the proposed remedies as pieces in a shell game. The proposed public oversight board, she says, is riddled with loopholes that will render it ineffective and even counterproductive.

Front-page shots of WorldCom, Adelphia and other former senior corporate executives being trotted off in handcuffs are undoubtedly meant to show the world that corporate fraud will not be countenanced, but that message is less convincing when the only news regarding Enron is that the

complexity of the case is causing delay in bringing charges against its former top executives. In the case of those former corporate officers who are charged, the attorney general may talk about prison terms of 65 years, but other news stories focus on the luxury accommodations these men can expect and the relatively brief time they are likely to serve, if they ever see the inside of a prison.

Lawmakers in both parties have conceded that the newly enacted measures are a first step toward correcting corporate mismanagement and misconduct, toward punishing those who have defrauded investors and employees and preventing future abuses. Reforming corporate boards would be an excellent next step. Why? Well, for reasons that are either terribly obvious or altogether inscrutable, even a cursory check of some of those who have been forced from their lofty management positions with some of America's leading corporations over the past two years shows that many of these individuals continue to sit on the boards of other companies. Is the U.S. so bereft of talent and experience that large companies must rely on those who have already demonstrated their incompetence, greed and disdain for public trust?

Another reason is that many boards, as they now function, seem unable to set any upward limits on top executives' salaries and benefits, and this is accepted even by some who are seen as authorities in corporate governance. In a recent interview with Al Hunt, on CNN's *Capital Gang*, for example, Nell Minow, of TheCorporateLibrary.com, could not agree with the reasonableness of Peter Drucker's idea that no CEO should make more than

20 times that of the lowest-paid worker in a company. She offered no alternative number and, in reply to another question, thought Jack Welch's pay of as much as \$136 million a year was "almost" justified. In such a climate, there is hardly any need for an executive to worry about his or her own personal greed. Perhaps the work of Charles Lewis' Center for Public Integrity may provide some more helpful views.

The New York Stock Exchange last week adopted new board rules for companies trading on the exchange, requiring companies to have a majority of "independent" directors and to obtain shareowner approval before issuing stock options. The new rules, which are not yet final, stipulate that to qualify as an independent director, a person cannot have been an employee of the company or its auditing firm for the past five years and must have no material relationship with the company. Like the new federal law, however, the rules proposed by the NYSE do not require directors to personally certify the accuracy of financial disclosures and do not specify accounting requirements for stock options. The proposed rules skirt other problem areas as well.

Changes recommended by one group on corporate governance suggest that outside directors on the board should evaluate the perform-

ance of the CEO against established corporate goals and strategies, and compensation should be linked to performance. An outside director should not be an employee or have any significant economic link with the company other than owning stock or receiving a customary fee for services. Bankers, outside attorneys, suppliers and customers cannot be considered as outsiders. The group endorses the view that outside directors should have a designated leader—a view that has gained support in recent months—and should screen and recommend candidates for the board.

In a letter last March to *The Credit Union Times*, a publication of the National Credit Union Administration, Michael G. Clinton, a director of the Affinity Federal Credit Union in Bedminster, NJ, suggested that the NCUA bylaws offer a model for the organization of boards of directors that may be helpful in thinking about how corporate boards might be improved. Under the bylaws, no paid employee of a credit union may be a member of the Supervisory (Audit) Committee, the Credit Committee, or the Nominating Committee, for example, and the Nominating Committee reports to the board of directors, not management.

There are clear conflict-of-interest standards, Clinton points out. "All directors, committee members, offi-

cers, agents and employees are prohibited from deliberation upon or determination of any question affecting their personal and/or direct or indirect pecuniary interests." "Disclosure of such interests," he says, "is not just the personal responsibility of the 'interested' party, but also a collective one." Members have a responsibility to raise the issue of another's 'disqualification' should there be some question regarding a possible conflict.

Other corporate board issues, such as qualifications, communication and information, compensation, tenure and membership on other boards, need greater scrutiny as well. These are complicated matters, with no easy answers. But boards of directors are, after all, responsible for corporate governance; the economy, the stock market, investors and the public are waiting to see such responsibility in action.

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