

# A NEW BREED OF DIRECTOR EMERGES AS PUBLIC POLICY ENTERS THE BOARDROOM

By Nels Olson

The global credit crisis and the resulting rescue plans have raised the specter of ongoing government involvement in corporate life. Public companies are now and will continue to be under a microscope to an extent they have never experienced before. Are boards equipped with the expertise to navigate successfully through this impending era of heightened scrutiny?

The Obama administration and Congress have signaled clearly their intention to impose oversight and reform, not only in the banking sector, but also in other industries, such as automotive and energy. Corporate boards will likely find themselves playing under new rules in a wide range of activities, including setting executive compensation. And the pressures won't be coming just from the White House and the Capitol.

Most European nations have followed the example of British Prime Minister Gordon Brown, who in designing a financial rescue package for his country's banking system, insisted on his government owning a major share of the participating banks (with accompanying voting rights), and also set restrictions on executive compensation and shareholder dividend policies. It is safe to assume that before long at least some of this fervor will travel across the Atlantic.



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Today’s boards, therefore, will be expected to watch over an organization’s various risks, while at the same time help corporate management develop strategies to cope with the myriad of regulatory and policy issues that may affect their businesses. As a result, it may be more important than ever for nominating committees to consider candidates with strong backgrounds in government policy making.

### Why Public Policy Experience?

Setting aside for a moment the anticipated oversight stemming from the global financial crisis, a brief review of proxy statements reveals the breadth of social policy issues already confronting corporations. General Motors Corp. shareholders, for example, in 2008 put forward proposals regarding national healthcare reform and adoption of a corporate plan to reduce total greenhouse gas emissions from company products and operations, among numerous other initiatives.

At Microsoft Corp., shareholders proposed requiring management to institute policies to protect freedom of access to the Internet and also sought to establish a separate board committee on human rights. Healthcare reform and human rights-related initiatives also emerged among shareholder proposals at Boeing Co. in 2008.

Grappling with issues like these requires more than just financial literacy skills. “Individuals who have had direct responsibility in areas important to the company and have a regulatory perspective are valuable,” says Vic Fazio, a former Congressman who currently sits on the board of Northrop Grumman Corp., adding, “It is an additional benefit if these people bring gender or ethnic diversity to a board.” During his 20 years in Congress, Fazio served on the House Armed Services, Budget, Ethics and Appropriations Committees.

John Castellani, president of Business Roundtable, concurs. “The politics of governance have entered the boardroom. So, understanding regulations and management of the proxy process, as well as having the ability to withstand the heat of politics are skills boards can really use.”

And then, there are the uncertainties regarding future government involvement. “The whole question of how much intrusion and regulation is appropriate is under discussion,” says Kenneth M. Duberstein, chairman and CEO of The Duberstein Group, and the former Chief of Staff to President Ronald Reagan. “Obviously, it’s not zero. But just how much is right?” Duberstein currently serves on the boards of Boeing, ConocoPhillips, Mack-Cali Realty Corp and The Travelers Companies.

### **New Leadership for a New Era**

It is no surprise then that the implosion of the U.S. economy and the corresponding international fall-out have given rise to a call for a new type of business leadership. And, because they set strategy and recruit and supervise senior management, corporate boards will have to be the first responders to this mandate.

In a *Fortune* magazine article on the topic, Jim Collins, author of the classic business book, *Good to Great*, says that he believes legislative – not executive – skills are what will be valued now in business leaders. He predicts that the most revered CEOs will be those who create the conditions for getting things accomplished, as opposed to those who give orders in top-down management style.

In the same article, David Gergen, director of the Harvard Business School Center for Public Leadership, is quoted as saying, “The CEO of the future is going to have to be someone who deals well with government.”

This new mood has not escaped the notice of those who educate future leaders at our most prestigious business schools. In a November 2008 *Forbes.com* special report, Sharon M. Oster, dean of the Yale School of Management says, “Of the many lessons we can learn from the challenges confronting today’s global economy, two seem especially pertinent for those of us who are involved in graduate management education: the inextricable linkage of the private and public sectors and the critical need for principled leaders with broad perspectives.

“Our students must understand that even the narrowest business decision can have wide-ranging consequences. Further, the idea that a business decision can be made in isolation – from ethical, political, social, environmental, regulatory or a host of other ‘non-business’ considerations – is approaching obsolescence.”

Harvard Business School Dean Jay O. Light concurs. “Leaders in this new era will need to be able to operate more effectively in a world defined by closer relationships between government, business and other stakeholders. From climate change to international poverty, the most pressing challenges of our time will demand a response that is beyond the reach of any single group, organization or sector of our economy.”

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### Adding a New Voice

Corporate boards will have to blaze this new leadership trail by bringing new skills and ideas to the boardroom. During this decade, boards have begun to recognize this. An internal analysis of Korn/Ferry’s Global Board Services (GBS) proprietary database reveals that between 2000 and 2007, the number of directors with prior government experience who sit on Fortune 1000 boards increased by nearly 16 percent. The GBS database, started by Korn/Ferry in 1994, gathers information from proxies and other public documents and currently contains research on more than 20,000 executives.

The introduction of a new viewpoint in any board discussion can bring great rewards. In his book, *The Medici Effect*, entrepreneur and author Frans Johansson argues that the most creative ideas occur when different disciplines intersect. The book’s name stems from the Medici family of Florence who in the 15th century used its wealth and influence to attract artists, musicians, scientists, architects, poets and merchant bankers to that city, laying the foundation for the Renaissance, one of the most creative periods of history.

While innovation per se is not the job of a corporate board, designing innovative solutions to business problems is. And, that is where a diversity of experience and knowledge can have its greatest impact.

For example, global policy experience adds an important dimension to boardroom discussions. “You can always find people with finance backgrounds,” says Duberstein. “The importance of people who understand the public arena and the big issues of international significance is greater now than ever before.”

This sentiment is echoed by Constance Horner, former assistant to President George H.W. Bush and a Brookings Institution guest scholar during the 1990s. “A person who has served in the public sector understands regulators’ patterns of decision making and the incentives they have for making their decisions.”

As is to be expected with any director from a non-traditional background, there is a learning curve. “A director who has never been embedded in a business will not yet have a developed business instinct,” notes Horner, who is now lead director at Pfizer Inc., as well as a director of Prudential Financial Inc. and Ingersoll Rand Co.

These directors will need to become more conversant with finance and accounting practices, as well as gain a better understanding of line operations, something they do not encounter in the public sector

where their work is less bottom-line oriented. In addition, they will need to make decisions in a new environment. Horner notes that in government work you have the advantage that generally you know your opponents. “They’ve come to talk with you. They speak to you through the news media or political allies,” she says, adding, “In the private sector, though, that’s not the case. So, you may need to operate with less knowledge of the competition.”

### Improving Director Education

The corporate governance changes that have taken place during this past decade, including stock exchange listing rules requiring that a majority of directors be independent, make it clear that independent directors are here to stay and that corporations must step up their efforts to help these outsiders understand the company’s business and the issues that affect it.

This is critical within the context of risk management. “If there is anything we’ve learned, it’s that boards need to be more diligent, more skeptical on risk management issues,” says Business Roundtable’s Castellani. “This is not just for financial services companies, but for all companies because of the broad nature of the problems. What’s happened has intensified the scrutiny on boards.”

Castellani points to a positive trend he sees among corporations seeking to improve director literacy: providing access to company executives without the presence of the CEO. “Directors are then able to speak to the CFO, the business managers, and ask the tough questions,” he says. “Directors and companies realize there is value in doing this.”

### Winning the Recruitment Game

While traditional director candidates, such as former C-suite occupants, bring the necessary broad background to the director’s job, they are difficult to recruit. Since the passage of the Sarbanes-Oxley legislation, many boards now restrict the number of directorships their CEO may hold or prohibit such service, as is the case with GE. Also, the added responsibilities of audit and other committees imposed in the post-Enron corporate scandal era have made board service time consuming. It is not uncommon for directors to report spending 200 hours per year meeting their board responsibilities.

In addition, more stringent conflict-of-interest policies prevent directors from serving if they are employed by professional services firms that do business with the company. As a result, the pool of

### Why Consider Government Executives for Directorships?

Change isn’t coming. It’s here. The global financial crisis has created a game-changing scenario in which corporate boards increasingly will find themselves grappling with government laws, regulations and policies. Among the reasons nominating committees are well advised to consider government executives for board vacancies are:

- The trend toward government involvement in business is clear, both in the U.S. and abroad. Knowledge of the legislative and policy-making process will inform corporate strategy.
- The financial crisis has prompted a call for a consensus-building style of corporate leadership that is better equipped to understand the interconnection of business decisions and social policy. Boards will need to respond by recruiting, retaining and rewarding these new leaders.

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- The addition of public policy viewpoints will allow boards to analyze risk within a broader context, thereby improving effectiveness.
- Government executives view corporate directorships favorably as a way to continue serving society. They represent a ready and qualified pool of candidates who can bring diversity and fresh perspectives to a board.

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director candidates with legal, accounting and other credentials is further limited because board service may mean losing a current or prospective client.

Best-in-class nominating committees, therefore, will find it useful to broaden their search to include individuals with executive-level experience working in government and for public policy-making entities. While these individuals may not have as extensive a corporate finance background as traditional director candidates, their in-depth understanding of the legislative and regulatory processes, two critical areas for optimal risk management, may be exactly what corporations need to create effective strategies in today’s environment.

Precedent is abundant. For example, APX, Inc., a provider of software solutions for the energy industry, tapped Carol Browner, former Environmental Protection Agency head under President Bill Clinton, for its board. Former Missouri Congressman Richard Gephardt sits on several boards, including those of United States Steel Corp. Erskine Bowles, who is currently president of the University of North Carolina and in the Clinton Administration headed the Small Business Administration and served as White House chief of staff, is a director of GM and Morgan Stanley. He is joined at the latter firm by Laura D’Andrea Tyson, former chair of Clinton’s National Economic Council and the President’s Council of Economic Advisors. Tyson is currently on the faculty of the Haas School of Business, University of California, Berkeley, and also is a director of AT&T, Inc. and Eastman Kodak Company.

In our experience assisting board nominating committees, we have found that former government administrators, rather than legislators, generally have the most relevant skills, although one can always point to exceptions. “Corporations will find that Executive Branch managers and other high-level government administrators, by and large, have more experience in executive decision making and a greater understanding of how issues intersect than do former legislators,” Duberstein notes.

### **A Willing Pool of Candidates**

For corporations seeking to diversify their boards, improve board effectiveness and manage the challenges of future government regulation, we encourage the inclusion of non-traditional candidates from the public policy arena in the search process.

Nominating committees should not hesitate to approach former government executives. “Board service allows a former public sector executive to participate in something else significant in American life. It’s another opportunity to serve,” says Horner. “I have no doubt that public sector executives view board service as desirable. They are excited to see how another part of the economy operates.”

Boards who take this innovative approach will be rewarded with an enhanced ability to fulfill their fiduciary responsibilities to all stakeholders through their improved risk management capability and their deeper understanding of this new marriage between business and government.

### In Every Director Search, the Fundamentals Apply

When beginning the director recruitment process, the first step should always be assessing a board’s recruitment needs in the context of four critical factors for board effectiveness:

1. Board composition
2. The board’s role
3. Its prioritized agenda
4. Board performance metrics

Once key issues are identified, they must be included in the criteria for selection of new directors, and the board’s ability to help the executive leadership team to manage these issues must become a key metric in measuring board performance. This will ensure that goals are met and that directors are making the best use of their talent and skills.



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#### **About The Korn/Ferry Institute**

The Korn/Ferry Institute was founded to serve as a premier global voice on a range of talent management and leadership issues. The Institute commissions, originates and publishes groundbreaking research utilizing Korn/Ferry's unparalleled expertise in executive recruitment and talent development combined with its preeminent behavioral research library. The Institute is dedicated to improving the state of global human capital for businesses of all sizes around the world.

#### **About Korn/Ferry International**

Korn/Ferry International, with more than 90 offices in 40 countries, is a premier global provider of talent management solutions. Based in Los Angeles, the firm delivers an array of solutions that help clients to identify, deploy, develop, retain and reward their talent.

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