CORPORATE BOARDS **USA**

# Boardroom Fundamentals 101
# Module 4: Traditional Areas of Board Oversight

Prepared by
Linda Iannone

# Oversight role of the Board

- Board's role is primarily one of oversight
- Day-to-day operation and execution of Board decisions handled by management
- Peter Drucker's formulation:

*"Noses in, fingers out."*

# STRATEGY

Board is responsible for setting the strategic direction of the company, with significant input from management, which considers:

- Where are we today?
- Where do we want to be?
- How do we get there?
- How do we measure success?

# Strategy (cont.)

- Often, boards and management meet at an offset strategy planning session to determine the company's vision, mission and goals
- Prior to the offsite, management develops a strategic plan, usually covering a 3-5 year cycle
- Active discussion, including effective challenge by board members, occurs which can result in board approval of the plan or a request to management for refinement
- Approval of the strategic plan includes allocation of resources to support the plan
- Management then executes the plan, with periodic updates to the board on status

# STRATEGY (CONT.)

Areas of strategic focus often include:

- Competition and current market conditions
- Industry trends
- Financial objectives
- Human resources
- Customers
- New product and services development
- Growth opportunities
- Mergers & acquisitions
- Technology
- Reputation

# Financial performance

- Oversight of a company's financial performance is directly aligned with the board's duty to provide value to shareholders
- Board members should understand the key drivers of revenues, profits, capital and expenditures (inflows and outflows) and act as stewards of corporate assets
- Financial performance should be a topic at each board meeting and may include budget-to-actual performance, trend analysis and comparisons to peers

- Boards typically review quarterly earnings releases and approve the financial statements for inclusion in the annual report to shareholders
- Board members, particularly the Audit Committee, should be attuned to red flags in financial reporting, such as excessive debt, large amounts of non-recurring revenue sources, income growth materially higher than peers, aggressive one-time adjustments and significant contingent liabilities

# Risk Oversight


- Boards are responsible for understanding the company's risk profile and ensuring that risks are identified, measured, monitored and controlled
- Risk management v. risk oversight:
  - Boards should not be involved in day-to-day risk management activities
  - By contrast, board involvement in risk oversight includes ensuring that a risk management framework is in place, including personnel, policies and procedures, designed and implemented in a manner consistent with the company's strategy and risk appetite

# Risk Oversight (cont.)

Specifics of board risk oversight:

- Understanding key risks facing the company
- Ensuring management has effective controls in place to mitigate risks
- Assessing key risk indicators to monitor direction of risks (increasing, decreasing, stable)
- Setting risk limits and risk appetite
- Monitoring action plans that address/reduce significant risks
- Assessing compensation plans to ensure they do not inappropriately reward excessive risk-taking
- Anticipating future risks

# Mergers & Acquisitions


- Depending on the size or significance of the transactions and state law requirements, Board involvement in mergers & acquisitions includes:
  - Setting direction for overall merger strategy
  - Understanding impact of transaction on financial condition, profitability, earnings per share and other financial measures
  - Reviewing results of due diligence findings and fairness opinions
  - Approving merger agreement
  - Ensuring sufficient resources are in place to integrate acquired businesses
- If the company itself is to be acquired, the board should seek advice from legal counsel and investment bankers to ensure that sufficient steps are undertaken to fulfill fiduciary duties and avoid shareholder litigation and director liability

# Ethics & Compliance


- Recent corporate scandals demonstrate the need for effective board oversight of the company's ethics & compliance program
- Boards should ensure that the CEO, executive management and the board itself **set the appropriate "tone from the top"** designed to communicate that integrity, ethical behavior and compliance are expectations that permeate the organization
- Codes of conduct, ethics policies, training, a whistleblower hotline and frequent communication on the importance of ethics & compliance should be established to guide and enforce the appropriate corporate culture
- The board should receive regular reporting from the Chief Compliance Officer about the status of the ethics & compliance program, including instances of noncompliance, ongoing investigations, regulatory issues, risk assessments, status of training, legal and regulatory changes and their impact on the business
- The board itself should also be trained on the company's code of conduct, ethics policies and sexual harassment in the workplace

# Ethics & Compliance (cont.)

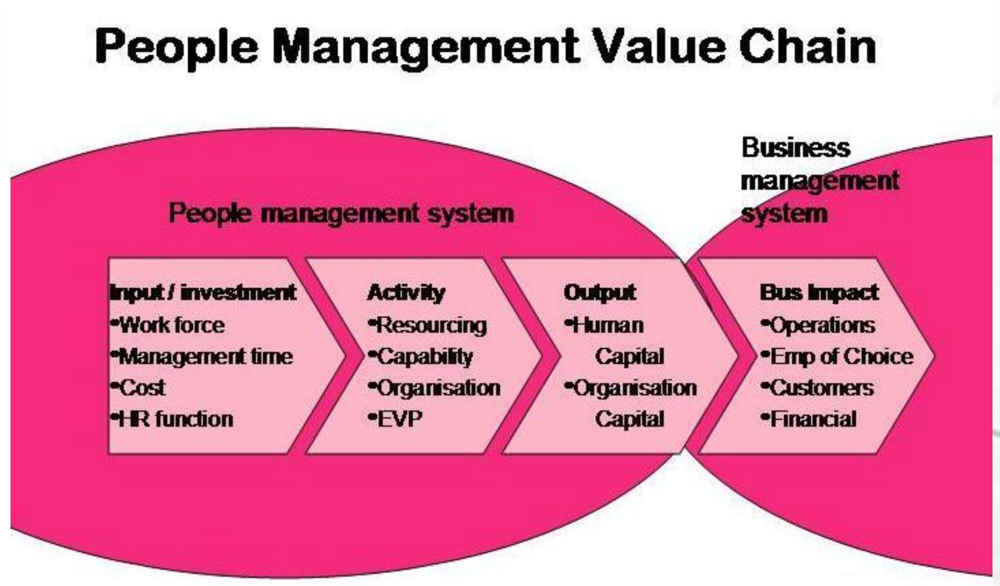

- An effective compliance program can help reduce fines and other penalties imposed on an organization in the event of criminal conduct. Elements of an effective compliance program under the DOJ Guidance on Evaluation of Corporate Compliance Programs (June 2020) include:
  - Tone and conduct at the top
  - Risk assessment
  - Written policies and procedures
  - Training and communication
  - Sufficiency of resources
  - Testing and monitoring
  - Confidential reporting structure and investigation
  - Third party management
  - Mergers & acquisitions due diligence
  - Systems of incentives and discipline
  - Lessons learned

# Human capital management

- While overseeing the CEO remains a top priority for boards, oversight of human capital has become a common boardroom agenda focus
- Human capital management—hiring, training, rewarding and retaining the right personnel—boosts employee morale and improves bottom line results
- Often, boards delegate oversight of human capital management to compensation committees, but the full board should have visibility into this critical area

# Human capital management (cont.)

- Board's responsibility is to ensure that an underlying structure exists to monitor and address issues of human capital, including
  - Succession planning throughout the organization
  - Skill gaps
  - Turnover trends
  - Compliance and Ethics
  - Competition for talent
  - Pay equity
  - Hiring practices
  - Employee engagement and development
  - Productivity
  - Diversity



# Crisis management

Any number and type of crises may confront a company without warning, some of which may endanger the continuing viability of the enterprise. Boards must be vigilant and nimble to help guide the organization through these challenges, which may include:


- Pandemics
- Product failures that endanger life
- Sudden death or resignation of the CEO
- Material financial irregularities
- Significant cybersecurity breaches
- Working conditions that threaten health and safety of employees
- Improprieties by senior executives

# Crisis management (cont.)

- Prior to a crisis emerging, the board should ensure that a crisis management plan is in place, including escalation mechanisms to the board level, and that the plan is regularly tested
- Although tempting to lead the response through a crisis, the board should instead serve a critical oversight, strategic and support role for management
- Once the crisis has subsided, the board should undertake a post-mortem review to understand the causes of the crisis, assess the success of the response and identify areas of improvement for future events

# Reputation

- As fiduciaries, boards are guardians of their companies' reputation, whatever that may be for any particular company

# Shareholder interests

- Boards' primary fiduciary duty is to serve the best interests of shareholders who ultimately express their views by voting directors in or out
- While boards may (or should) consider other constituencies, such as customers, regulators, employees and society at large, shareholders continue to be paramount
- Boards often need to balance short-term v. long-term shareholder interests and determine the actions that best create value for the corporation and its shareholders
- For example,
  - Should capital be allocated to a share repurchase program that can benefit stock price in the short-term, or should capital be preserved for a potential economic downturn or future business combination that can benefit shareholders in the long-term?
  - Is the company's business viable for long-term profitability or should the company be sold now to enhance shareholder value?

# Shareholder interests (cont.)

- Shareholder activism by institutional investors and individual shareholders is alive and well.  Methods used:
  - Proxy fights to replace existing board
  - Shareholder proposals to be included in proxy statements
  - Media campaigns
  - Recommendations by proxy advisory firms which can include a recommendation that shareholders withhold votes on the slate of directors up for reelection

# TECHNOLOGY

- With the evolving and dynamic nature of technology and corporate dependency on technology to drive business, board oversight of technology has become an imperative
- Boards are not expected to be technology experts, but often seek to appoint at least one member with technology background
- Oversight of technology includes ensuring that existing technology meets the needs of the business, adequate resources are allocated to technology projects, key executive positions are staffed with knowledgeable and capable technology experts and a strong information security management program is in place

# Self evaluation

- Boards of companies listed on the NYSE are required to conduct an annual self-evaluation
- For other companies, even private companies, a board self-evaluation is a best practice
- Self-evaluation process usually led and conducted by the Nominating and Governance Committee and can result in action steps, depending on results
- Each director completes an evaluation questionnaire covering topics such as board dynamics, effectiveness, operations and composition
- Some boards couple the questionnaire with interviews, which can be conducted by a third-party governance expert to elicit more candid responses
- Each committee of the board may also conduct a separate self-evaluation

# QUESTIONS?

Contact Linda via email → **lindaiannone35@gmail.com**

# End of Module 4

CORPORATE BOARDS USA