

# Assessing the Risks of Corporate Directorships

By John H. Stout

Directorships are part-time jobs. They are specialist positions that require knowledge about governance, as well as business, financial, and group-process acumen. As the recent Enron and WorldCom proposed settlements underscore, they entail legal responsibilities, statutory duties, and potentially serious liability. They require objectivity, independence, oversight skills, personal integrity, and knowing when to persist with a contrary point of view and when to be collaborative. So how should a person evaluate a job that requires such considerable skills, beyond making sure he or she has them? Make some inquiries. Do some due diligence.

**Integrity.** Assuring the integrity of the company is a director's most important and most challenging task. Assess the company's integrity with its employees, owners, customers, suppliers, and financiers. Directors must see the company's integrity as intertwined with their own personal integrity. If senior management and your fellow board members don't see it that way, don't serve.

**Governance.** Governance is about proactive oversight of management, not management. If the other board members don't understand the fundamental distinction between governance and management, avoid serving on that board. A board packed with high-achieving, successful people won't assure a high-performance, successful board unless the directors truly understand governance and have the requisite oversight skills and experience.

**Governance environment.** Is there agreement among the board on the governance practices appropriate to the particular company? Are they articulated in writing? Are they imple-

mented? Does the board update itself on governance issues, best practices, and conduct which results in litigation? Boards and directors opposed to continuing education on governance subjects should be avoided. Good governance is about good practices, continuing education, execution, and evaluation.

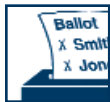
**Board composition.** Find out what skills the other directors have. No need to be the Lone Ranger on a board. Think about the types of people needed by this particular board. How are directors selected? Does the board analyze the skills needed on the board as part of the selection process? Was the process organized by the board's independent directors, or was it controlled by a particular person or group? If management or a dominant shareholder group controls the board, ascertain their agenda, and be careful about serving.

**Board organization and leadership.** How is the board organized? Does it have the necessary committees? How are the committee members selected? Who presides at board meetings and executive sessions of the board? Is there independent board and committee leadership? Does the leadership promote and observe good governance practices?

**Board/management relations.** Directors need to be schizophrenic: proactive overseers on the one hand, effective collaborators with management on the other. It must be clear that the CEO works for the board, not the other way around. If the CEO isn't committed to excellence in governance, if the board isn't clear in practice about its role vis-à-vis management, or if the board is basically a rubber stamp for management proposals, avoid serving as a director.

**Mission/values/culture.** Does the company have a well-articulated mission and set of corporate values? Does the board support these values implicitly and explicitly, by its selection of directors, its CEO selection, the conduct it rewards, holding management accountable for building a culture of fairness, trust and high performance, and how it deals with issues and concerns brought forward by employees and lower-

**Director Summary:** To decide whether to join a board, do some due diligence on key areas of the company and its board: integrity, governance, board composition and leadership, values, planning, conflicts of interest, special expertise, accountability, human resources, board duties, director protection, and governance ratings.



## If the board is basically a rubber stamp for management proposals, avoid serving as a director.

level management? Does the board understand and take responsibility for the company's culture? Even though it's becoming a cliché, the "tone at the top" starts with the board.

**Planning.** Does the company have a plan that it follows? Read it. Does it reflect the mission and values of the organization? Is there an adequate assessment of the company's strengths, weaknesses, opportunities, and threats? Does it adequately balance short- and long-term value creation and performance?

**Conflicts of interest.** Is the board truly sensitive to conflicts of interest and properly cautious in dealing with them? Independence and objectivity are important in discharging a director's duties. Personal relationships among directors, or between directors and management, are closely examined by the media, investigators, and litigants when problems arise. Be extremely cautious about an environment where relationships may in actuality or perception compromise board objectivity. These issues also arise when a director, or an organization with which he or she is associated, is a customer, supplier, controlling shareholder, beneficiary of corporate gifts, and so forth.

**Special expertise.** If an invitation to serve is occasioned by a person's special expertise, greater responsibility and reliance on that expertise by other directors may result. Make every effort to ascertain the consequences of accepting an appointment based on that expertise. Be sure that the board has other experienced directors who have commensurate responsibilities, and that the governance environment on the board is conducive to the utilization of the special knowledge of the various directors.

**Accountability.** Does the board effectively evaluate management and itself? Does the board appropriately hold management accountable for corporate performance? Does the board have performance objectives for itself, and does it hold itself accountable for achieving those objectives? Are directors evaluated individually? Is evaluation and feedback embraced as a means of enhancing board and management performance, or is it avoided as a threat to collegiality and collaboration?

**Human resources.** Boards typically take responsibility for allocating and overseeing a company's financial resources. What about its human resources? Is the board holding management accountable for conduct and policies that are fair to the workforce as a whole? Is there a

comprehensive organizational philosophy that fairly allocates compensation, incentives, benefits, accountability, and opportunities across the entire workforce? This is a key aspect of building a great culture.

**Board duties.** Does the board understand its legal duties of good faith, care, loyalty, compliance, and oversight? How is the board educated regarding these duties? Are there procedures and processes in place to assure that it is properly performing its responsibilities? What committee is responsible for overseeing corporate compliance with laws, regulations, and the company's governing documents, key agreements, and internal policies? Does the board have individual contact with the CFO, inside and outside legal counsel, internal audit, risk management, human resources, and do the individuals responsible for these functions have and use direct access to the board? Does the board seek special counsel on particularly sensitive issues when it needs to?

**Director protection.** Are the board and management sufficiently aware of the risks of director service? Are the risks openly discussed? Does the board have the resources needed to carry out its work? Is compensation appropriate given the skills, time required, and risks involved in director service? Are resources provided for board education and orientation with respect to the industry in which the company competes, the business of the company, and current governance developments? Are directors appropriately indemnified from, and insured against, liability?

**Governance ratings.** For public companies, one or more organizations will have published their assessment of the company's governance as a rating or score. These assessments may provide an informative "independent" view of the company's governance from the perspectives, and with the biases, of the particular ratings organizations, and should be reviewed.

A serving director will want to frequently evaluate these subjects. A person invited to join a board should consider discussing these matters with several of the following: the search professional (if one is involved); the board chair; CEO; lead director; chair of the audit, governance, or compensation committee; corporate and outside counsel; internal and external auditor; banker; key customers and suppliers. Some basic due diligence will provide an excellent perspective on the risks of a particular directorship. ■

**John H. Stout** chairs the corporate governance group of Fredrikson & Byron, P.A. ([www.fredlaw.com](http://www.fredlaw.com)), and is an adjunct professor of law in Minneapolis where he teaches a course on corporate governance. He is a past director of NACD and chairs its Minnesota chapter.