Special Report

The Board In A Crisis Economy

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The world is in financial turmoil, and America is in the middle of a still-spreading economic contraction – some say it will be the worst since the Great Depression. The $700 billion financial rescue plan is now the law of the land, but we don't yet know if it is enough or how long it will take to right ourselves; some are talking 2010 and beyond.

Snap judgments are already being made by politicians about where to assign blame. With the glaring exception of anyone associated with the Bush administration, do not expect anyone within the Beltway to accept any culpability for America's debacle.

What you can expect is that leaders in the private sector – and, that will certainly include corporate board members – will figure prominently among the suspects to be hauled in for interrogation before the "Peoples" committees and subcommittees on Capitol Hill. Candidates of both major parties have made it amply clear that the guilty will be admonished, judged, and summarily punished – all in the course of the same afternoon, if possible. For those able to escape actual prosecution, public spirited trial lawyers will ensure the "guilty" are made to pay.

All of this may sound disturbingly Kafkaesque, but the message is already coming through loud and clear: rampant greed, a lack of regulation, poor corporate governance and oversight all helped to precipitate this calamity. Only more, much more, regulation and strictly mandated corporate governance can restore order in the face of a greedy capitalist calamity.

In fact, the verdict is already in. The American public believes that the international market meltdown was the inevitable result of poor management at many levels, including corporate boards sound asleep at the switch.

Indeed, for better or for worse, boards are squarely in the crosshairs.

Boards have already been under relentless pressure for granting big pay packages to underperforming CEOs. Now, directors are coming under fire for what politicians and the news media have convinced the public was precisely the kind of lax oversight that led to Enron and the enactment of Sarbanes-Oxley in 2002 and all that followed. Apparently, none of this government-mandated governance was sufficient to keep the corporate "crooks" at bay. But Congress in its wisdom will not be as lenient this time around.

With the world in crisis mode, how can boards navigate this unprecedented terrain? Never in the past seven decades has there been such urgency for management and boards to work together to achieve real transparency and accountability.

What Should Boards Do Now?

The CEO, in particular, and the board of directors must project an air of calm, stable management. Senior executives and the board must be in alignment during this difficult time. There are a number of strategic moves that can and should be made make now.

If practical, consider establishing a special committee of independent directors to help the company navigate the crisis and determine remedies. The lead director should head this effort.

Ideally, a board-management crisis communication plan should have kicked in by now. (If there isn't a plan, it is not too late to create one.) The board and management should be in daily contact, certainly with the lead or presiding director and the special committee. The company should know where to reach key directors (chairs of the audit and risk management committees, as well) at a moment's notice. Make use of additional layers of communication, including videoconferencing, texting, conference calls and other methods. Be mindful that all such records are discoverable.

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The lead or presiding director should be taking a very active role, passing key information to the rest of the independent directors and relaying board concerns to management. Now is not the time for directors to be out of touch.

Areas in which the board can take a leadership role:

Risk Management:

• If the board doesn't already have a risk management committee, create one, drawing from members of the audit committee initially. In a crisis, the risk committee should be meeting regularly, not just once or twice a year. It should appraise the whole board frequently. The entire board must be engaged in risk management.

• Conduct a comprehensive review of the company's risk exposure, working with the CFO, comptroller and others. The full board could be liable for any management misrepresentations so there must be a policy of zero tolerance surprises or less than frank communication between management and the board.

• Install a risk-assessment process for the committee and board to follow. Some boards draw up a checklist, which the lead director and members of the committee use to query heads of business units. Again, the findings go back to the full board for oversight and action.

Expenses & Compensation:

• Eliminate all unnecessary board expenses and, if feasible, agree to a cut in director retainers in line with reductions in senior management salaries. Can outside board members afford to work for $1 a year, take a reduced retainer or increase common-share purchases during the crisis?

• Make executive compensation as bullet-proof as possible, adopting new, permanent criteria going forward. The public is furious at outsized pay packages, and the board can take steps to make sure the company is not in the line of fire. Conduct a full-blown review of senior executive pay, especially the top five officers and division heads. Scale back restricted stock grants; take a careful look at deferred compensation. Finally, lay out the amended plan publicly in simple terms for all constituents.

• Establish independent standards for any compensation expert working with the board. Toughen pay-for-performance metrics.

• Will the CEO agree to a new, reduced employment contract – not only during the crisis but going forward? In effect, the CEO can set a new standard, which can send a powerful signal to competitors and beyond.

• Will the CEO and senior managers agree to a reduced cash-only salary or a limited grant of common shares during the crisis, redeemable on a set date at the market price? Will they agree to purchase common shares on the open market with their own money or, if they already do, will they buy more?

• Be sure there are no hidden unpleasant surprises against company policy, such as nepotism or outstanding personal loans to directors or executives (banned under Sarbanes-Oxley for years).

• Review all executive perquisites, down to the smallest privilege, and treat them as line-item vetoes. Remove them if there is no good reason for them.

• Consider a clawback provision that enables a company to recoup incentive pay from a top executive who, in retrospect, actually failed to meet established performance standards due to subsequently discovered accounting errors or other misstatements for which he or she bears responsibility.

Board Structure & Policies:

• Install a non-executive chairman who has no connection with the company. Governance is moving in this direction, and CEOs who chair their boards and are in crisis mode are less apt to argue now. Boards can make a compelling argument for this arrangement.

• Consider asking a retiring director who is a strong contributor with needed expertise to stay on as a member of the board for an additional year, temporarily suspending age or term limits. NOTE: This shouldn't be construed as a way to keep underperforming directors who are reluctant to retire.

• Review the D&O policy. Install a crisis plan and practice scenario planning.

• Engage in board-building:

- Seek outside candidates who are comfortable with risk and crisis, recognize warning signs and aren't afraid to ask tough questions. Recognize that desirable individuals may be running their own businesses and not have the time to take on board service. The search will be tough.

- Attract candidates who are actively running businesses or who are, at most, only one or two years into retirement. Companies that ran into trouble have been criticized for larding their boards with consultants, longtime retirees and directors with little crisis experience.

- Purge the board of directors who aren't actively contributing.

• Make it clear that the new governance policies, unless otherwise stipulated, are permanent. Directors who don't agree with them should be encouraged to retire discreetly.

Boards should look upon the economic crisis as an opportunity for a comprehensive scrutiny of the company's corporate governance. These actions must be fully disclosed to the company and beyond as new rules of governance going forward. If they're perceived as window dressing, everyone will suffer, from management and the board to shareholders, customers, competitors, employees and others. The loss in goodwill would be incalculable.

By word and deed, management and the board must establish a shared mission and convey to all that they are in it for the long haul and that, together with all constituents, they will weather this storm.

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