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# Who's in Control, the Board or the CEO?"

Presentation to the  
Master's program in corporate governance  
Hanken School of Economics

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EPFL and Swiss Finance Institute

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- The following slides based on PowerPoint slides created by Professor David F. Larcker, Corporate Governance Research Program, Stanford Graduate School of Business
  - The full versions are accessible at:  
<http://www.gsb.stanford.edu/cgrp/topics/directors/presentations.html>
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## Board of Directors of the Average Large U.S. Corporation

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Number of directors	11
Number of meetings per year	8-9
Independent directors	82%
Independent chairman	16%
Dual chairman/CEO	63%
Lead director	95%
Independent audit committee	100%
Independent comp committee	100%
Independent nom/gov committee	100%
Average age	62
Mandatory retirement	75%
Mandatory retirement age	~70
Female directors	16%
Boards with at least one female director	89%

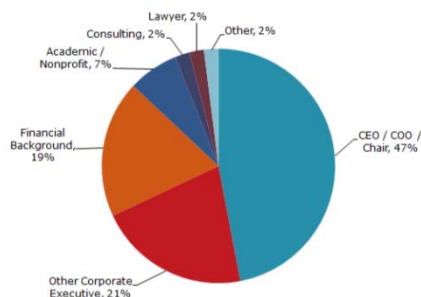
Source: Spencer Stuart(2009)

## Directors - Backgrounds

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- Directors have a mix of managerial, functional, and specialized backgrounds.

Background of New Independent Directors



Spencer Stuart (2007)

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## BOARD OF DIRECTORS – WHAT DOES A BOARD DO AND HOW DOES IT DO IT?

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### Responsibilities

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- The board of directors has a dual mandate:
  1. Advisory: consult with management regarding strategic and operational direction of the company.
  2. Oversight: monitor company performance and reduce agency costs.
- Effective boards satisfy both functions.
- The responsibilities of the board are separate and distinct from those of management. The board does not manage the company.



OECD Principles of Corporate Governance:

"The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders."

OECD (2004)

## Responsibilities

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Selected advisory and oversight responsibilities:

- Approve the corporate strategy
  - Identify risk areas and oversee risk management
  - Hire and fire the CEO and other key employees
  - Design executive compensation packages
  - Ensure the integrity of published financial statements
  - Approve major asset purchases
  - Protect company assets and reputation
  - Represent the interest of shareholders
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## Independence

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- Boards are expected to be independent:
    - Act solely in the interest of the firm.
    - Free from conflicts that compromise judgment.
    - Able to take positions in opposition to management.
  - “Independence” is defined according to regulatory standards.
  - However, independence standards may not be correlated with true independence.
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## Operations of the Board

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- Presided over by chairman: sets agenda, schedules meetings, coordinates actions of committees.
- Decisions made by majority rule.
- To inform decisions, board relies on materials prepared by management.
- Periodically, independent directors meet outside presence of management (“executive sessions”).



Directors report spend 20 hours per month on board matters. While a typical meeting lasts between 2 and 6 hours, some last as long as 8 hours

Corporate Board Member and PricewaterhouseCoopers (2009)

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## An awesome paper

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- Schwartz-Ziv, Miriam, and Michael S. Weisbach, 2011, What do boards really do? Evidence from minutes of board meetings
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## Board Committees

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- Not all matters are deliberated by the full board. Some are delegated to subcommittees.
  - Committees may be standing or ad hoc, depending on the issue at hand.
  - All boards are required to have audit, compensation, nominating and governing committees.
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How is a director elected, and  
can everybody do the job?

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## Market for Directors

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- Are there enough “qualified” directors?
- If supply > demand, companies should have no trouble identifying and recruiting qualified candidates.
- If supply < demand, board quality will suffer. Inadequate supply need not be broad-based; it may be concentrated in specific areas.



- 56% of directors believe there are not enough qualified directors.
- Directors most difficult to recruit include ethnically diverse (57%), women (50%), technological expertise (45%), and international expertise (42%).

Corporate Board Member and PricewaterhouseCoopers (2009)

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## Directors Terms

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- Two main election regimes:
  1. Annual election: Directors are elected to one-year terms.
  2. Staggered board: Directors are elected to three-year terms, with one-third of board standing for election each year.
- Staggered boards are an effective antitakeover protection.
- Staggered boards may also insulate or entrench management.



### Prevalence of staggered boards:

- Approximately half of all publicly traded companies have a staggered board.
- Small companies are more likely to have a staggered board than large companies.

SharkRepellent (2009)

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## Director Elections

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- In most companies, directors are elected on a one-share, one-vote basis.
  - Shareholders may withhold votes but not vote against.
  - Typically, only one slate of directors is put forth for election; in a contested election, a dissident slate is also put forth.
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## Director Compensation

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- Compensation must be sufficient to attract, retain, and motivate qualified directors.
- Compensation covers time directly spend on board matters, cost to keeping schedule flexible to address urgent issues, and financial and reputational risk from corporate scandal or lawsuit.

(median)	Revenues > \$20 bn	Revenues \$1 - \$2.5 bn
Annual Retainer	\$ 80,000	\$45,000
Committee Fees	10,500	16,200
Non-Retainer Equity	105,800	57,800
Total Director Comp	\$229,900	\$132,600
% Equity	45%	46%

Hewitt (2010)

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## Director Compensation

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- Companies pay fees for serving on committees.
- Fees are intended to compensate for time, expertise, and potential risk of committee role.

(median)	Revenues > \$20 bn	Revenues \$1 - \$2.5 bn
Audit Retainer	\$10,000	\$ 10,000
Audit Meeting Fee	2,000	1,500
Audit Chair	20,000	12,500
Comp Retainer	\$ 9,500	\$ 5,000
Comp Meeting Fee	2,000	1,500
Comp Chair	15,000	8,250
Nom/Gov Retainer	\$ 9,000	\$ 5,000
Nom/Gov Meeting Fee	2,000	1,500
Nom/Gov Chair	10,000	7,500

Hewitt (2010)

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Board structure and its consequences  
for firm performance and corporate  
policies

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## Board Structure

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- Boards are often described in terms of their salient structural features: size, independence, committees, diversity, etc.
  - Do these attributes have an impact on the board's ability to monitor and advise the corporation?
  - Do companies with certain structural features perform better/ worse than those who lack them?
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## Board Size

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Board size tends to be correlated with company revenue.

- Small companies (<\$10 billion): 7 directors, on average.
- Large companies (>\$10 billion): 12 directors, on average.
- (+) Large boards have more resources.
- (+) Allow for greater specialization.
- (-) Greater cost (compensation, scheduling conflicts, etc.).
- (-) Slow decision making.



- Larger boards tend to provide worse oversight (when company size is held constant).
- Large "complex" firms (those with multiple business segments) benefit from larger board size while large "simple" firms do not.

Yermack (1996); Coles, Daniel, and Naveen (2008)

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## Independent Directors

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- Independent directors are those who “have no material relationship” with the company (as defined by the NYSE).
  - A director is not independent if director or family member has, in the last three years:
    - Served as an executive of the listed firm.
    - Earned compensation > \$120,000 from the firm.
    - Served as an internal or external auditor of firm.
    - Served as executive at another firm where CEO of listed firm was on compensation committee.
    - Served as executive of another firm whose business with the listed firm is \$1 million or 2% of revenue.
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## Independent Directors

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Independent judgment is critical to the advisory and monitoring functions of the board.

- (+) Offer objective evaluation of company and management.
- (+) Allow for arms-length negotiation of compensation.
- (+) Make decisions solely in the best interest of the company.
- (-) Directors who meet NYSE standards may not be independent.
- (-) Social ties may compromise judgment.
- (-) Only effective if they are qualified and engaged.



- Outside directors improve some governance outcomes, such as M&A premiums.
- Their effectiveness depends on their cost of acquiring information about the firm.
- True independence of judgment may differ from regulatory independence.

Cotter, Shivdasani, and Zenner (1997); Duchin, Matsusaka, and Ozbas (2010); Hwang and Kim (2009)

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## Chairman of the Board

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- The chairman is the liaison between the board and management, and between the board and shareholders.
  - The chairman presides over the board, schedules meetings, sets the agenda, and distributes materials in advance.
  - The chairman leads the discussion of important items, including strategy, risk, performance, compensation, succession, and mergers.
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## Chairman of the Board

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Should the chairman be independent?

- (+) Clear separation from management.
- (+) Clear authority to speak on behalf of the board.
- (+) Eliminates conflicts.
- (+) CEO has more time to run the company.
- (-) Artificial separation if dual Chairman/CEO is effective.
- (-) Difficult to recruit new CEO that expects to hold both jobs.
- (-) Complicates decision making.



- No research evidence that an independent chairman improves or destroys shareholder value.
- Decision to separate should be based on situation.

Boyd (1995); Brickley, Coles and Jarrell (1997)

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## Lead Independent Director

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- The lead independent director presides over executive sessions of the board.
  - The lead director may play a prominent role in evaluating corporate performance, succession planning, director recruitment, and board evaluation.
  - The lead director serves as a single point of contact between nonexecutive directors and management, institutional investors, and the media.
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## Independent Committees

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- Committees of the board deliberate topic-specific issues that are critical to the oversight of the company.
  - Directors are selected to committees based on their qualifications and domain expertise (generally).
  - The audit, compensation, and nominating/governance committees are required to be independent (Sarbanes Oxley).
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## Busy boards

- “Busy” director: director holds multiple board seats (generally 3 or more).
- “Busy” board: a majority of directors are busy.

Total unique directors	29,089	
Directors with:		
1 board seats	24,144	
2 board seats	3,583	
3 board seats	1,020	} Potentially busy directors
4 board seats	254	
5 or more	88	

Corporate Board Member and PricewaterhouseCoopers (2009)

## Busy Boards

Are busy directors better or worse corporate monitors?

- (+) Bring important experiences from other directorships.
- (+) Broad social and professional networks.
- (+) May have high integrity (reason they are in demand).
- (-) May be too busy to properly monitor.
- (-) May be less available at critical moments.



- Companies with busy boards tend to have worse long-term performance and worse oversight.
- Busy boards are less likely to fire an underperforming CEO.
- Busy boards award higher compensation.

Fich and Shivdasani (2006); Core, Holthausen, and Larcker (1999)

## Interlocked Boards

Interlocked boards: the CEO of Firm A sits on the board of Firm B, while the CEO of Firm B sits on the board of Firm A.

- (+) Creates a network between companies.
- (+) Facilitates the flow of information and best practices.
- (-) Creates a dynamic of reciprocity.
- (-) Can compromise objectivity and weaken oversight.



- Network connections generally improve corporate performance.
- Effects are most pronounced among companies that are newly formed, have high growth potential, or in need of a turnaround.
- At the same time, interlocking leads to decreased monitoring (less to terminate underperforming CEO; award higher compensation).
- Companies must balance trade-off.

Larcker, So, and Wang (2010); Hallock (1997); Nguyen-Dang (2009)

## Diverse Boards

Do diverse boards provide better advice and oversight?

- (+) Broader array of knowledge, experience, and perspective.
- (+) Lessens “groupthink” (premature consensus).
- (+) Encourages healthy debate.
- (-) Diverse groups exhibit lower teamwork.
- (-) May lead to “tokenism.”



- Evidence on the relation between diversity and corporate performance is largely inconclusive.
- Modest evidence that female representation improves governance quality.
- Diversity for the sake of meeting arbitrary quotas is clearly detrimental (the cost of inexperience outweighs the potential benefits).
- Mentoring and development improves director qualification.

Wang and Clift (2009); Hussain, Kassim and Bill M. Kwila. 2009; Adams and Ferreira (2008); Ahern and Dittmar (2010)

## Summary of Evidence

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Structural Attribute	Findings from Research
Independent Chairman	No evidence
Lead Independent Director	Modest evidence
# of Outside/Independent Directors	Mixed evidence
Independence of Committees	Evidence for audit committee
Busy Boards	Negative impact
Interlocked Boards	Positive on performance Negative on monitoring
Board Size	Negative impact (unless company is "complex")
Diversity	Mixed evidence

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## Big names in Boards of Directors Research

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David Yermack (NYU)  
 Anil Shivdasani (UNC)  
 David Larcker (Stanford)  
 Mike Weisbach (Ohio State)  
 Bob Parrino (Texas Austin)

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