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To Our Clients:

Corporate Governance:
The Role of Directors

In a recent speech, Chancellor William Allen of the Delaware Court of Chancery set his views as to the role of corporate directors:

> The conventional perception is that boards should select senior management, create incentive compensation schemes and then step back and watch the organization prosper. In addition, board members should be available to act as advisors to the CEO when called upon and they should be prepared to act during a crisis: an emergency succession problem, threatened insolvency or an MBO proposal, for example.
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> This view of the responsibilities of membership on the board of directors of a public company is, in my opinion, badly deficient. It ignores a most basic responsibility: the duty to monitor the performance of senior management in an informed way. Outside directors should function as active monitors of corporate management, not just in crisis, but continually; they should have an active role in the formulation of the long-term strategic, financial, and organizational goals of the corporation and should approve plans to achieve those goals; they should as well engage in the periodic review of short and long-term performance according to plan and be prepared to press for correction when in their judgment there is need.
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> Effective long-term monitoring requires more of outside directors than an appreciation of the scope of their responsibility. It requires a sympathetic and productive relationship between the outside board members and the CEO and the acknowledgement by the CEO of the

legitimacy of the monitoring role and its requisites. More than this, effective sympathetic monitoring requires a commitment of time and resources, especially information, and sometimes independent advice. A few hours a quarter may satisfy the role of passive advisor in good times; it is not sufficient to meet the obligation to act as a monitor. The demands of the position, if properly understood, are inconsistent in my opinion, with service on an impressively long list of boards.

There are a host of innovations or mechanisms that might be explored to develop a board that functions like a sympathetic, long-term owner, rather than as either a passive advisor or merely as a financial investor. A non-CEO, board chairman (along the English model) may prove to be attractive to some companies, but not for others; a periodic meeting of the outside directors outside of the presence of the CEO might be helpful; direct access to corporate information and personnel might be possible; periodic, structured meetings between outside directors and large, long-term shareholders might prove productive; board size might be reduced so that meetings implicitly invite participation and acceptance of responsibility. I don't mention these possibilities as any endorsement of them, but as examples of the sort of moderate adaptation that is possible. In all, corporate governance -- including the way in which the board regularly functions and the processes through which it interacts with the corporations' senior management and with the corporations' long-term stockholders -- should be thought of as one source of possible competitive advantage; as one way to make the organization function more effectively. The corporations' own techniques and mechanisms of governance should themselves be the subject of explicit board discussion and review from time to time.

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When I consider the role of corporate director in the context of global economic competition, I begin to see the role of outside

director as a private office imbued with a public responsibility. In most contexts, the director's responsibility runs in the first instance to the corporation as a wealth producing organization. Promotion of the long-term, wealth producing capacity of the enterprise inures ultimately to the benefit of the shareholders as the residual risk bearers of the firm, but it also benefits creditors, employees as a class, and the community generally.

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