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SPECIAL FEATURE: BOARDS COST TOO DAMN MUCH!

Yes, public companies have an increasing level of worry over their corporate governance/board issues today, from liability, to risk management, to mandated disclosures, to proxy ballot issues. But ask the corporate counsels and corporate secretaries who actually handle the paperwork of governance, and they have a more down-to-earth problem -- paying the boardroom bills.

The soaring costs of corporate governance last popped up as an issue right after the passage of Sarbanes-Oxley, and especially when Section 404 compliance came into effect. We were all assured that the spike in governance spending would ease after SOX was in place. The *rate* of increase may have declined, but governance costs continue to climb, and it looks like pending reforms will reignite boardroom inflation. Boards need to review far more today, adding to paperwork expenses. Audit, comp, and the board overall face strong legal prods to hire more outside counsel and consulting advice, none of which is cheap. Internal costs for board support, such as research, presentations, and board logistics, are climbing, and have to come out of someone's budget. Money saved through new e-proxy rules is devoured by the IR demands of getting enough investors to vote at all.

No, this isn't a corporate crisis. It's more like a slow drag, an accumulation of governance pennies that add up to serious dollars. Many companies are still at the stage of striving to meet the new governance demands, and just paying the bills as they come in. Stage two, the one we're preparing you for below, is the sticker shock that hits when you total up the numbers.

-- *RDW*

4 QUESTIONS FOR YOUR BOARD EXPENSES

Want to get a handle on exploding board and management expenses? Before coming up with answers, let's ask a few questions:

- Does your current board budget reflect the *true* cost of governance, or only a narrow, board-specific slice? Are there board and governance-related costs currently being eaten by the budgets of other departments (HR, legal, finance, etc.) that wouldn't be incurred if not for board-related demands?
- Do you have an internal accounting system that can reflect such "unaccounted" time and costs as part of your real board spending? Further, have you set accounting definitions and controls that workably differentiate between

board costs, and wider “governance” spending (investor relations, filing fees, shareholder services, regulatory spending, etc.)?

■ Has your board discussed and set a policy on seeking, contracting and paying for its own dedicated outside advisors (comp, legal counsel, etc.)? Does the policy strike a considered, defensible balance between letting the board and committees hire such counsel as it sees fit -- while preventing uncontrolled budget busting that may not really add to good governance? Do all board and committee requests for outside advice go through a central board “gatekeeper?”

■ If a sudden need for such pricey outside advice arises, will the board and staff be forced to scramble for the talent it needs at whatever price is demanded? Should the board and staff try some scenario planning that involves researching a menu of specialty legal, pay, etc. advisors it might need in various situations? Does the board currently have its own outside legal representation on retainer? Should it?

SHAPING YOUR BOARD BUDGET

It’s a basic of any business process -- budget setting. Yet when it comes to the corporation’s board of directors, the process can be vague, subjective and tough to enforce. However, the first step in sticking to any budget is *setting* that budget, so let’s start by filling in the budgetary blanks for your board.

The late Douglas Austin, founder of the Austin Financial Services firm, wrote [a good article](#) on board budget writing a few years back. Though his items were addressed to bank boards (and today some are a bit dated -- board “country club memberships” are included), overall they give a solid outline of items to build into any board’s budget, and include:

- Annual director retainers and monthly fees.
- Committee fees.
- Any deferred compensation not listed above.
- Expenses for board meetings (facility costs, meals, mileage, air fares, lodging, etc.)

The next step is to account for indirect expenses, such as:

- Secretarial expenses, primarily salary and expenses of the corporate secretary’s office dedicated to board work.
- Legal expenses for the time and work of in-house counsel.
- Fees for the services of outside advisors, including legal, accounting and compensation advice.
- Board education, related materials (magazine subscriptions, internet materials), and any costs for a board retreat.

As you can image, the latter “indirect expenses” are the toughest to measure (and often the costliest).

BOARD COST MANAGEMENT - 4 TIPS

Knowing how to design a board budget is one thing. Making it realistic and accountable (and sticking to it) is another. For last month’s Q&A I spoke with Kris Veaco, head of consultant Veaco Governance Services, and I’ve gone back to her again for board budgeting tips from the perspective of the corporate secretary (who typically has to make the budget work in the real world):

■ Make sure that the company’s overall budget has a line item for “board expenses” -- and that *everyone* who has anything to do with the board is able to use it. “Certainly for larger companies you want to keep all the board expenses in one place,” says Veaco. In her corporate secretary experience, “we always had one cost center devoted to the board.” This is vital not only to capture various board-related expenses (who pays for the time HR spent in chasing down a data bit for the comp committee?), but to properly divide those that could be obscured in a general “etc.” category. “I also had a cost center for shareholder activity, and another for running our office,” recalls Veaco.

■ The best way to start the budgeting process in the above article is by “looking at last year -- look at board meetings, where they’ll be, travel and other reasonable expenses, and so on.” Build out from these numbers by asking company counsel and other interested offices (such as HR) how ongoing rule changes will shift board budgets in the year ahead (more demands for pricy outside advice?). Of course, the board and committee chairs need to be involved in setting the budget as well, for their on-the-ground view of where more spending is required (and, you hope, where it could be cut). No one person in the corporate structure is the single authority on how much the board will need to spend.

■ As noted above, “unplanned” board related expenses often prove the largest. These can include added pay

consulting work, sudden legal spending for dealmaking, lawsuits or regulatory actions, or a proxy battle. Yet “unplanned” expenses are sometimes those you just haven’t worked hard enough at planning for. “I’d ask our compensation consultants what expenses they anticipated for the year ahead,” says Veaco of her career as a corporate secretary. “They usually know the level of activity, and can foresee what’s coming, so I was usually pretty close on the budget.” If the board has set up relationships with outside advisors in advance of most one-off events, these advisors should be able to give you good “what if” budgets for various scenarios.

■ As you can guess, any budget area that is A: vague and B: lacking in central oversight will tend to inflate itself. That’s why Veaco has found it helps when “most of this goes through the corporate secretary’s office, or the counsel’s office.” Committee chairs don’t just ring up a comp consultant or lawyer on their own for boardwork (or at least they shouldn’t). Typically, requests to “find someone” go through the secretary, company counsel, or the head of HR. This gives the board both the independent counsel it needs -- and central gatekeepers who can tell the board just how costly it is.

HOW WE MOVED OUR BOARD ONLINE

Another step in cutting board and governance costs is to get aggressive on moving boardwork out of the paper and face-time realm and into the electronic world. Aside from spending a lot of time on the phone (which your directors already do anyway), this means stronger use of teleconferencing and online board portals.

We’ve discussed the latter quite often over the years, but online governance, like all governance, can be done both well and badly. If you want to know how to do web governance right, ask the people who’ve done it. Armsmaker Sturm, Ruger & Co. recently put its 9-member board online using the Diligent “BoardBooks” platform. We asked Leslie M. Gasper, corporate secretary for Ruger, what first-hand lessons she’s learned in moving her directors to an e-board.

“We started about 6 months. One of our directors recommended going online from another board he serves with. We looked into it, and thought it had potential. Our goal is to go completely paperless, but, with our Diligent site, the directors are already able to view material quickly, and can print them if they need to. That cuts down on producing board books and FedExing them before each meeting, which saves paper, shipping costs -- and my stress level. This is a work in progress so far, but everybody likes the system.”

Gasper’s tips on making online governance work:

■ A boardroom “champion” who brings personal experience with (and support for) web-based governance from another board is very helpful. “The director who brought this to our attention was very enthusiastic about it, and that was absolutely a plus.” Directors respect a colleague who endorses something, and who offers first-hand proof of its value.

■ Train early, and take your time. “I think having the directors learn the system over the past 6 months has helped,” says Gaspar. “It’s helpful to have directors do training as soon as possible so they’re all onboard.” Even the best software is not as intuitive as it claims to be. Just throwing a program at busy directors and expecting them to poke around and teach themselves only leads to early discouragement.

■ Maybe 100% “paperless” doesn’t need to be your goal. Just adding *some* online board services, or other electronic media, saves money, so trying to squeeze out those final few board adapters may not be worth the effort. For example, Gaspar says her company also uses WebEx web conferencing for some board and committee work, but blends this with onsite member participation. “Our audit committee is a mix of directors who are local, so some meet in person.” Don’t assume the use of board meeting tech must be an all-or-nothing choice to cut board costs.

7 BENCHMARKS OF A BEST-PRACTICE COMP COMMITTEE

With 2010’s strong proxy season focus on executive pay, board compensation committees now realize that doing a good job of crunching numbers and judging performance isn’t enough. The board must now be able to objectively *prove* that it has the structure, processes, independence and expertise to do a good job on top pay.

That’s where [Soundboard Review Services](#) comes in. This new firm was launched last summer with a simple premise -- investors face more proxy proposals on executive comp, and need an independent audit of just how fair and professional a companies’ paysetting system is. Further, the companies themselves have proven willing to pay for such a “good paykeeping” seal of approval. Soundboard has been busy performing comp committee audits at firms like DuPont, but co-founder Josh Lurie took a few minutes to tell me a few items the firm looks for in a best-

practice compensation committee:

- Is the committee engaged in *all* aspects of the executive pay process (internal and external discussions, etc.)?
- Does it avoid formulaic equations in setting pay, but instead use good, informed business judgment?
- Is the comp committee active in identifying and responding to potential issues on its own (not just waiting for management to tell them something's awry)?
- Are committee members committed to being knowledgeable on current pay issues, and to keeping themselves educated?
- Does the committee look at *total* compensation over the *long* term (rather than just snapshots of the various elements)?
- Do the levels of incentive payouts (both long and short term) increase *and* decrease over time?
- Do the pay peer groups really make sense, and is the company appropriately placed within its peer group?

Q&A: Should We Rotate Our Committee Chairs?

Q: "I'm corporate secretary and general counsel of a large regional health care services firm. We recently merged with another firm and that (along with several planned board retirements) is driving us to rethink some of our board structures. The current chairs of our audit and compensation committee have held their positions for some years, and one is among the planned retirees. The board asked me to look into best practice on committee chair tenure and rotation, but I haven't been able to find much. Any advice?"

A: Committee chair rotation is a topic that's seen shifting sentiments over the years. There are good arguments in favor of rotating chairs out after a number of years (becoming too much of an "insider;" general staleness), and against (good finance talent is already hard to find; it takes a few years for a chair to become effective).

"This should never be done lightly, or by rote," counsels Kris Veaco (see above,) who suggests that your board review the present and projected work demands on the committees, projected governance challenges, and the current effectiveness of the committees. This requires a strong board and committee evaluation system, which Frederick Lipman, head of the [Association of Audit Committee Members](#) and a partner with Blank, Rome, supports as being more effective than a blanket chair rotation or tenure rule. "I think this should be a part of annual evaluation of overall committee effectiveness -- to me that's the way to do it."

There seem to be few solid bylaw rules out there that set chair rotation terms, with the mentions that do exist calling for review of tenure based on "the best interest of the company." Still, you can find a number of online board guidelines and bylaws that address the issue of how long a committee chair should hold the job. The [New York Stock Exchange](#) recommends "periodic" consideration of the issue for its members, a review that [Dynergy Corp.](#) writes into its governance guidelines. [NorthEast Utilities](#) recommends that its board committee chairs rotate out every 5 years, and [Medtronic](#) every 3 (5 for the chair of their governance committee). Tellingly, all of these are just recommendations, not solid mandates.

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RALPH WARD'S BOARDROOM INSIDER is published monthly for directors, CEOs, those who work with corporate and nonprofit boards (corporate secretaries, corporate counsel, support staff, and consultants), and those who are board prospects.

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