



DIRECTOR CHARACTERISTICS

by Robert A. Singer

Much has been made of the impact of the Sarbanes-Oxley Act, related SEC regulations and preceding market rules applicable to boards of directors and board committees of public companies. Directors of many private companies with relatively large numbers or multiple groups of shareholders are also worried that these new laws establish best corporate practice standards that could be applied to them in claims by dissatisfied minority owners. Is all this concern warranted? No. In many ways we have entered a new era of corporate governance. But, it is imperative that boards not be so focused on rules that the primacy of the substance of directors' qualifications is diminished.

Honorable and effective corporate governance cannot be legislated. Although politicians and pundits often claim that the new statutes and rules will prevent excess and fraud, the truth is that almost all of these initiatives are primarily structural and/or procedural. Financial information and systems will be tested and reported upon internally and externally through certain new mechanisms. The independence of directors will be analyzed under revised standards. Various board committees will have specified compositions and deal with issues, complaints and other matters according to certain acceptable methodologies. These procedures and structures are valuable and will make the harm that inattentive, negligent or even corrupt management (executive officers and directors) can cause more difficult to achieve. They do

not, however, touch upon the core components of quality corporate governance: good and competent people.

Corporate law requires capable and honest leaders. At the same time it recognizes imperfect human nature. The law requires that good (honest and ethical, but not perfect) directors make good (well-informed and carefully considered, but not perfect) decisions for good (reasonable and loyal, not personally advantageous)



reasons, which they believe (reasonably, not with pristine accuracy) are in the best interests of their company and its shareholders. Procedures can help direct the decision-making process and rules can prohibit certain actions, but the character and ability of those making the decisions will always be the ultimate determinates of quality corporate governance.

In working with scores of public and private company boards over the last 25 years and serving on a half dozen

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boards, I have listened to numerous nominating committees, board chairs and chief executive officers discuss potential new board nominees and whether to re-nominate directors with expiring terms. The traditional nominee characteristics often cited in these discussions remain relevant and useful, but the new era of board scrutiny arising from the excesses and outright fraud of recent times of recent times has brought into sharper focus those factors which are primary and necessary.

Traditional And Useful Characteristics

There are a number of factors that traditionally have been considered as keys to board membership. These are not unimportant and indeed are often useful criteria, but they should not be viewed as sufficient standing alone.

- Business Generation. Many companies seek directors who can bring in business. A director with relationships that will yield loan business, create sales opportunities, or enhance dealings with vendors is a valuable commodity. A director with these ties does support the company's success. This is a pragmatic reality. But, without more, how does this characteristic contribute to the board's primary responsibility of making good decisions?

- Prestige. Some boards are punctuated with one or more "names." It is believed that affiliation with one who has achieved recognition in a particular field or endeavor enhances board credibility. This is often true. A name director who possesses the necessary characteristics discussed below is indeed an asset. On the other hand, a director that brings only recognition is an empty suit or dress.

- Affability/Collegiality. A high value is sometimes placed on a nominee's ability to work (or even play) well with others. Obviously, directors that are able to function as colleagues without tension are more likely to manage more efficiently, if not necessarily more effectively. Affability is, however, not an adequate substitute for capability.

- Longevity. Length of service to a company is many times an unspoken motivator of re-nomination. There are valid reasons. A director of long-standing may well have much knowledge about the company and its industry and be experienced in analyzing trends less obvious to a newcomer. On the other hand, it is not unusual for the tank to run dry. Board participation may become more of a habit than a commitment, but the prestige and compensation resulting from service may be difficult to give up.

- Significant Stock Ownership. Significant shareholders are often directors. This makes sense for them, and can make sense for the company. Such a director's interests are more closely aligned with other stakeholders. Alignment of interests, however, does not necessarily translate into board competency.

Necessary Characteristics

In today's world of increased scrutiny and evaluation through hindsight, the substance of a board's decision-making is critical. Although perfect decisions are not the required result, boards where those characteristics critical to making good decisions do not predominant will find defending their decisions to be difficult. Thus, selection of directors with these characteristics is, quite simply, necessary.

- Knowledge. There is no substitute for knowledge. Knowledge about the applicable industry is good, and knowledge about the company is even better. Knowledge, however, means something more. Directors who have an awareness of complex business issues, an understanding of a multitude of relevant factors, and the ability to assimilate and weigh options and alternatives are critical to a board's considerations of important matters and the evolution of its resulting decisions.

- Experience. There is no substitute for experience in making important decisions of the type that are a board's responsibility. Many people who are quite successful in

various endeavors are not necessarily prepared to be effective directors. For example, an entrepreneur who has successfully built her own business through risk-taking and sheer effort may well lack experience in making decisions in the more structured, careful and even conservative environment of a corporate board. Experience in making quick decisions when only one's own investment is at risk often does not translate to considerations affecting a body of shareholders with differing appetites for risk.

- Commitment/Time. Serving on a corporate board is not a hobby or a reward. It has become a difficult job requiring commitments of significant time, study and effort. For twenty years the courts have increasingly focused on whether board decisions were made by directors who have educated themselves about the relevant issues, considered information and opinions provided by board advisors, and carefully evaluated the potential impact of their actions on the company and its shareholders. Simply put, following the lead of an executive officer or a dominant director without taking the time to study and understand the issues is not competent decision-making. A potential nominee who cannot or will not provide a significant level of commitment should not be selected.

- Independence and Perspective. Under the new laws and market rules, "independent" directors are required to undertake a number of board duties. This concept means independence from executive management by reason of an absence of personal business dealings with the company or other relationships deemed to cause conflicting interests. Insofar as these rules go, they are indeed valuable. Independence as a board selection factor is a broader concept. The contributions of a director who will test the continuing validity of company "truisms," promote evaluations of new initiatives, and bring new perspectives cannot be overstated. All organizations over time are drawn to habit. Boards, executive officers and employees are

human, and we humans tend to seek comfort and a sense of control over our activities through patterns that become accepted and familiar. Change may not be necessary, but independent leaders willing to challenge tradition are.

No director possesses all characteristics that are useful or necessary for good corporate governance. Boards are, however, designed as collective mechanisms for reaching decisions where the strengths of the directors are aggregated to make the actions produced superior to those any individual can offer. Good companies have good boards, and good boards are the result of a thoughtful and continuing commitment to attracting directors with the characteristics critical to good decision-making.



If you have any questions concerning these requirements, or if you would like more detailed information, please do not hesitate to contact us.

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