2015 BRC: Board's Role in Driving Long-Term Value Creation

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Earlier this year, NACD's 2015 Blue Ribbon Commission published a report focused on the role and responsibility that boards have in helping managements balance short-term and long-term pressures to create lasting shareholder value. At NACD Chicago's November breakfast meeting, Mark Zorko, a principal with Brentwood Advisory and a Director of NACD Chicago, led a panel discussion on this issue, with panelists including John Edwardson, former Chairman and CEO of CDW and current director of FedEx and Rockwell Collins; Steve Kaplan, professor at University of Chicago's Booth School and a director of the Columbia Acorn Fund and Morningstar; and Bill White, a professor at Northwestern University and a director of NACD.

Zorko opened the program by stating that the "heart of a board's role" is creating value for shareholders based on a coherent long-term company strategy. The panel addressed a number of issues relating to long-term value creation including:

1. The question was raised as to whether short-term and long-term corporate needs and issues can be complimentary or must, of necessity, be in conflict. The panelists suggested that one way to create an on-going balance was to consider a company's long-term goals and objectives as a series of short-term steps.

2. There are lessons that public company directors and managements can learn from private equity board behaviors. The panelists compared the typical five- to seven-year exit strategy time frame of many private equity investments with the shorter three- to four-year time frame often adopted by public company investors, and they found the longer interval to be more conducive to successful strategic planning and execution. Secondly, the panelists felt that private equity boards often feel a stronger sense of urgency in creating value over a fixed period of time that could be useful for public company boards to consider. Counterproductive instances of "group think" are also less likely on private boards, which are typically less diplomatic and collegial than their public counterparts. Lastly, private equity investors typically use more stringent financial "gates" in evaluating capital expenditures and acquisition opportunities that lead to fewer dilutive transactions and investments.

3. The panelists discussed the role of activists, noting that there are more tools available to hedge funds and other investors today than there were in the 1990's. We have moved from an environment where hostile takeovers were the primary means for activists to create value to legislative fixes and more involvement from large institutional mutual funds; many of these funds manage index funds, so they can't simply "walk away" from a company they believe is underperforming for addressable reasons. In essence, activists today are using financial consulting-type tools to propose methods to increase the returns and margins of companies they believe to be underperforming.

4. In general, boards, more than managements, are the catalysts and custodians for creating effective, appropriate long-term shareholder value. If management is too long-term oriented, executives could

lose their sense of urgency, and the board will need to step in. Conversely, if management is too concerned with Wall Street's short-term fixation on earnings, then the board must keep management focused on the company's long-term strategy. The issue of whether board members should hold stock was discussed; while board equity ownership can align directors' interests with those of shareholders, it can also create too much of a focus on short-term performance. Edwardson noted that he looks for new board members who are of sufficiently "independent" financial means to be able to look beyond short-term stock performance as a key part of their compensation. Along the same lines, management teams overly interested in cash compensation versus longer-term stock plans should also raise red flags; Kaplan noted that private equity investors believe improving the linkage between performance and compensation plans is second in importance only to growth. In looking for additional clues that management may be too short-term oriented, the panelists suggested that board members take a hard look at customer satisfaction data; if financial results look good, but customers are unhappy, there's a red flag that short-term concerns may be taking precedence over creating long-term value.

5. The panelists discussed the need for board members to become sufficiently expert in industry and competitive trends in order to effectively guide a company's long-term strategy. The issues of term limits as an impediment to having an experienced board was also raised, with several panelists noting that it can take years, and several capital expenditure/budgeting/HR review cycles to become fully knowledgeable about a company's needs and options. Along the same lines, management teams should have a finite number of key statistics that they use to make sure the company stays on its long-term strategic trajectory, and executives should be able to easily and clearly convey these metrics to both the board and to investors.

6. Executive sessions are a key tool for boards to use in creating long-term value for shareholders, particularly in getting directors to be of "one mind" before offering suggestions and corrections to the management team.

The morning's session ended with a case study involving an underperforming public company under siege from an activist investor. The case was considered and reported on by groups of audience members, and their plans were publicly discussed and evaluated by the panelists.