

*Changing Board Expectations:
Implications for the CEO
and for HR*

Proceedings of the 2004 Fall Meeting

*by
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*Human Resources Policy Institute
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October 7 & 8, 2004*

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**Human Resources Policy Institute
2004 Fall Meeting**

Thursday, October 7, 2004

- 11:30 a.m. New Member and Guest Orientation
- 12:00 p.m. *Luncheon Buffet Begins*
- 1:00 p.m. **Welcome & Introductions**
Professor Fred K. Foulkes
Director, Human Resources Policy Institute
- 1:30 p.m. **Membership Roundtable Discussion**
- 3:00 p.m. *Coffee Break*
- 3:30 p.m. **Changing Board Requirements and Expectations —
Implications for the CEO and for HR — Part I**

Professor Jay W. Lorsch
Louis E. Kirstein Professor of Human Relations
Harvard Business School
- 5:00 p.m. Adjourn
- 5:30 p.m. *Cocktails*
- 6:30 p.m. *Dinner*
- 7:45 p.m. **The Coming Generational Storm —
The Realities of America's Economic Future**
Professor Laurence J. Kotlikoff
Chair, Department of Economics
Boston University
- 9:00 p.m. Adjourn



Friday, October 8, 2004

7:15 a.m.

Breakfast Buffet Begins

8:30 a.m.

**Changing Board Requirements and Expectations —
Implications for the CEO and for HR — Part II**

Mr. Roger Kenny
Managing Partner
Boardroom Consultants

9:45 a.m.

Coffee Break

10:15 a.m.

Panel — Conclusions, Lessons and Next Steps

Ms. Eileen Farrar
Senior Vice President, Corporate Human Resources
UnumProvident

Dr. Bruce Margolis, Ph.D.
Executive Vice President, Chief Human Resources Officer
The TJX Companies, Inc.

Moderator: Professor Fred K. Foulkes

11:30 a.m.

Wrap Up
Professor Fred K. Foulkes

11:45 a.m.

Luncheon Buffet Begins

1:00 p.m.

Adjourn

Executive Summary

Changing Board Requirements and Expectations — Implications for the CEO and for HR

As a result of scandals that have undermined the corporate governance system and eroded investor confidence, boards of directors are under greater scrutiny than ever before. A shift is underway from the often cited “country-club” board climate to one that more closely befits the needs of a complex governance system.

Throughout the day of Thursday, October 7, and the morning of Friday, October 8, Human Resources Policy Institute members engaged in a lively discussion of how boards are changing to meet governance challenges and also how those changes might alter HR’s role going forward. Meeting sessions focused on answering seven key questions about board governance.

1. What does it mean to be an independent director?
2. What criteria should be used to choose and evaluate directors?
3. What processes and group dynamics are most conducive to outstanding board functioning?
4. How should a corporation’s CEO be evaluated by the board?
5. How should independent directors be evaluated?
6. What information can and should be given to board members in order to ensure responsible and effective decision-making?
7. What processes will aid newly appointed directors in becoming oriented to their roles?



In addition, presenters and HRPI members discussed questions related specifically to HR's evolving role in governance.

1. What value can HR professionals add as liaisons between board members and management?
2. How should HR executives gain CEO support for this expanded role?
3. Given the importance of oversight of executive compensation as a board responsibility, are opportunities arising for HR professionals to become directors?

Throughout the meeting, HRPI members identified and discussed several pressing issues related to changing board expectations and the implications for senior executive and human resource professionals. It appears that management/board relations are an area in which HR may well be poised to take on a more strategic presence. Further, given the importance of CEO and management compensation as a board responsibility, we might find more HR professionals on boards in ensuing years.

Membership Roundtable Discussion

During the roundtable discussion, members focused on four topic areas: (1) legal issues related to FLSA changes; (2) health care; (3) compensation and reward practices; and (4) company approaches to acquisitions.

Federal Labor Standard Act Changes – Members initially discussed how the FLSA changes have impacted their respective organizations. To what extent have member companies reclassified roles from exempt to non-exempt, or vice versa?

One member commented on the challenge of changing the job content of reclassified roles; he noted the difficulty of hiring at the managerial level once a position has been reclassified from exempt to non-exempt because some of the core responsibilities have been altered. Another member stated new regulations and subsequent reclassifications have had very little wage impact at his organization, and that stores have adopted changes at their discretion.

Several members mentioned their concern with litigation, noting the \$18M settlement against Starbucks after 1,000 managers in California were judged to have been denied overtime despite their classified exempt status. Since the lawsuit, Starbucks has reclassified all employees as non-exempt, with the store manager as an exception. A few retail members noted that their organizations are moving toward this Starbucks model.

One member commented that his organization has had the opposite experience, in that formerly non-exempt employees are being reclassified as exempt. He highlighted the motivational problem that occurs when employees who were at one point given overtime pay are now unable to fully benefit from effort exerted beyond normal working hours.



Health Care – How are member organizations managing their healthcare retirement plans in light of pending legislation?

One member opined that private organizations are “slowly getting out of medical care.” Several HRPI members mentioned that their coverage continues to shift costs to employees. A few members stated that their respective organizations are no longer offering company contributions for retiree medical care and have eliminated spousal subsidies. Others offer graduated subsidies, based on age and years of service. One member organization has recently shifted its retiree medical plan from a self-insured program to a Retiree Medical Account (RMA). Two members commented that their respective organizations are heavily lobbying Congressional leaders in order to affect health care legislation.

A few member organizations are now offering Consumer-Directed Healthcare Plans (CDHP). These plans, often touted as the next generation of employee health benefits, help employers engage their employees to manage their benefits and care actively in order to better control costs. One company, for example, sends its employees personalized pharmaceutical lists which specify the dollar amount of prescription costs and identifies dollars that could be saved using generic equivalents. In essence, employees are shown ways to be more cost-effective.

Several HRPI members remarked that CDHP success results from an abundance of communication using newsletters, evening “town hall meetings,” and the company intranet. Another member noted that outsourcing health programs leads to concern among employees about security of confidential health information.

Compensation and Rewards – In light of the uncertainty around option expensing, as well as shareholder concern with executive pay and dilution levels, most HRPI member



organizations are scrutinizing their long-term incentive compensation plans. Three HRPI members mentioned that employee surveys showed a preference for restricted stock and cash, rather than stock options. Some HRPI member organizations are moving toward mixed models of restricted stock and options and/or are cutting the number of options offered in half. Two retail companies, recognizing that employees convert options to cash as soon as the options vest, are moving to offer cash in lieu of options.

One HRPI member stated that restricted stock is an excellent incentive for employees because of its dependable value: “It’s a matter of selling stability to people.” Another member, however, cited the difficulty of conveying the nature and benefits of restricted stock: “We had a hard enough time explaining stock options; restricted stock would be even more difficult.” To some extent, one member remarked, determining whether to use options, restricted stock, or cash depends upon the organization’s culture and employee needs. At technology companies, for example, employees are likely to be motivated by the potential of a tremendous upswing in option value. In contrast, retail employees, most of whom make under \$50,000, may be more attracted to the immediacy and certainty of cash.

A few HRPI members who continue to grant options noted that their respective organizations are using cliff vesting. One member commented on a four-year cliff and another explained a five-year plan in which no vesting occurs in the first year and then 25% percent vesting each year over the next four years.

Acquisition Best Practices – What are HRPI members’ best practice approaches to acquisitions? A few members noted the utmost importance of speed in getting systems converted, training employees, and communicating information to all relevant parties. Another member



commented on how post-communication follow-through is critical in maintaining employee trust. Other members highlighted how cultural differences between the acquiring and purchased organizations can have a dramatic impact on merger success.

One member remarked that her organization often prefers to make a joint venture investment rather than acquiring a company as a wholly-owned subsidiary. The technology firm's \$1B wholly-owned venture fund allows for investments that increase exposure to individual talent, niche players, and start-ups while minimizing the company's risk.

Acquisitions must be approached methodically and thoughtfully from purchase to integration, said one HRPI member. Details such as reconciling differences in titles between employees with similar responsibilities can greatly impact whether employees feel fairly treated and respected. Another member explained the significance of removing CEOs of acquired companies and placing the best-suited replacement candidates in their new roles sooner rather than later. One of his employing organizations waited ten years after acquiring a company before replacing its CEO; since installing the new CEO, the division has been three times more profitable.

Other Topics – Near the end of the meeting on Friday, HRPI members returned briefly to the list of roundtable discussion topics. One member asked for definition of a “blog.” A blog is a personal website that may include journal entries, commentaries and recommendations of news articles or other websites that are of interest to the user. It has also been referred to as a weblog. Some companies, such as Microsoft, are actively encouraging their employees to create public weblogs in order to facilitate communication with targeted groups of customers. However, blogs raise concerns for some employers around employees' misuse of company computers and the potential dissemination of confidential company information.

Changing Board Requirements and Expectations— Implications for the CEO and for HR—Part I

*Professor Jay W. Lorsch
Louis E. Kirstein Professor of Human Relations
Harvard Business School*

In their recent (2003) book, Back to the Drawing Board: Designing Corporate Boards for a Complex World, Professor Jay Lorsch and his co-author, Colin Carter, wrote: “...around the world, scandals and company failures have provoked a storm of criticism and well-meaning reforms. In response, a variety of ‘best practices’ have emerged, but can such ad hoc adjustments fundamentally change the capacity of boards to provide good governance?” (Carter & Lorsch, 2003).

Smiling at an overhead slide that read, “If it ain’t broke, don’t fix it,” Professor Lorsch pronounced, “It’s a lot broke.” Professor Lorsch provided HRPI members with a guided tour of the complex web of actors that comprise corporate governance systems and explained the “cycle of greed” that contributed to the wave of scandals in the early 2000s. Despite the myriad factors that account for the current crisis of corporate governance, he explained, boards of directors are at the center of America’s system of corporate governance. Further, while Sarbanes-Oxley and changes in the stock exchange listing requirements are intended to ameliorate the crisis, in the end, truly effective governance depends on what actually happens inside each board room.

A Broken Governance System

Given the existence of what was considered a sophisticated system of governance checks and balances, how is it that the corporate accounting and governance scandals ever occurred? Professor Lorsch described the system of corporate governance, which includes focal companies with their boards, management, and shareholders embedded in a larger context of such actors as security analysts, institutional investors, auditors, law firms, the U.S. Securities and Exchange



Commission, and the courts. The keys to effective governance, he explained, are twofold: (1) power for oversight of management; and (2) transparency and accuracy for investors.

Sources of power include laws and regulations (e.g., SEC), social norms and cohesion (e.g., boards), economic power (e.g., shareholders), and perceived legitimacy. Corporate boards of directors, although sanctioned by the regulatory environment, derive their true power from social norms and cohesion; put more simply, from the “power to work together.”

What was broken in 2001 and 2002? Despite the fact that banking analysts, auditors, and institutional investors all work within a system of strong rules, Professor Lorsch explained, “everyone seemed to begin to ignore them.” What these actors were doing was not always illegal, but rather, an ethical compromise. Analysts, driven by the incentive to provide high earnings per share each quarter, influenced corporate managers to produce such results. Auditing firms, facing the “commoditization” of audits, focused more attention on IT and tax consulting than on their former bread-and-butter, which created an erosion of audit practices and the accounting oversight of companies.

Thus began the cycle of greed, Professor Lorsch explained. Auditors allowed accounting tricks to abound. Institutional investors focused on short-term growth in earnings. CEOs who were compensated heavily by stock options were also inclined to focus on enhancing quarterly earnings per share and share price. Not surprisingly, Professor Lorsch stated, corporations ultimately engaged in accounting practices that, while not always fraudulent, “crossed over ethical boundaries.” For a while, all these actors were excited about quarterly earnings improvement.

As scandals surfaced, perceptions of executive integrity plummeted. Greed was seen to be dominant in the system. Accounting tricks and fraud were—and to some degree continue to be—

widespread among the American companies. What happened to effective oversight of management by corporate boards? They were not able to prevent these scandals. As a result Professor Lorsch stated, corporate boards struggled and will struggle with new demands and greater complexity. The passage of Sarbanes-Oxley, SEC regulations, and public expectations are placing more pressure on boards than ever before.

Board Best Practices

Professor Lorsch cited three assumptions that underpin board best practices:

1. Boards must be empowered;
2. The majority of board members must be “independent;” and
3. Directors’ incentives must be aligned with those of the shareholders.

One of the difficulties in implementing these assumptions to reach more effective governance is in the notion of what it means to be independent. Given the complexity of objectively defining independence, corporate boards themselves are now expected to stipulate which members are independent.

Professor Lorsch explained that, for him personally, the most troublesome of the four assumptions is the alignment of director and shareholder incentives. Companies are attempting to reach this alignment by compensating directors with stock. Critics of this practice assert that offering directors equity is, in essence, aligning their interests with those of managers, not shareholders. Professor Lorsch therefore advocates giving board members restricted stock or options, which cannot be sold prior to departure from the board, or, better yet, relying more on cash incentives.



A number of best practices related to board structure and processes have emerged in the last few years based on these assumptions. Included among those cited are: (1) having a leader of the independent directors (the “lead director”); (2) operating three board committees (audit, compensation, governance); and (3) board membership reflecting a portfolio of director talents. Professor Lorsch also mentioned board processes relating to key activities such as understanding the company’s strategy; CEO evaluation, tenure, and compensation; oversight of management succession; and provision of relevant information.

Making Boards More Effective

Professor Lorsch explained that boards face several constraints that often hinder their effectiveness. These include the “downside” of director independence, constraints of time and limited information, and group decision-making. The independence criterion for board selection, by its nature, will often result in board members who do not have a deep understanding of a company’s strategy and business processes. Further, Professor Lorsch explained, while directors are deeply committed to their responsibilities, they face time constraints as they are very busy individuals. A recent poll reported that board members dedicate an average of 120 hours a year to their directorship responsibilities, making time to conduct thorough and effective oversight a challenge.

How can board governance become more effective? *Time* and *information* are often “low-hanging fruit” that can be improved, according to Professor Lorsch. Boards can work smarter and use their time more efficiently by coordinating their respective schedules and developing clear agendas. Another way to enhance board functioning is for the board, senior executives and human resource professionals to clarify the board’s role and then provide members with focused information related to the business model and strategic and risk factors. This information should

go beyond financial reports and be holistic in terms of the business and the competitive environment in which it is embedded.

In addition to time and information, boards can perform better by improving their decision-making processes. The job of the chair, for example, is to assure that directors are knowledgeable about the organization and its competitive situation, to manage time at meetings, to encourage discussion among members, and to respect dissent. According to Professor Lorsch, responsible members should respect others' schedules, encourage management contributions, and work positively toward consensus-building.

Is the CEO the “fox in the chicken coop when she is also the chair of the board?” Professor Lorsch asserted that the CEO and the board should maintain two sets of roles and responsibilities that together contribute to shareholder value and an organization's health. It is important to be explicit about the responsibilities of each role as well as the roles and relationships between the CEO, chairman, and lead director. Boards members should feel comfortable with the various relationships and confident that the board is working well together.

In the end, Professor Lorsch stated, new laws and regulations can help boards to become better governance mechanisms, but the key to overcoming these limits is in the hands of each board. By clarifying their goals, their roles, and their design, boards are taking a step in the right direction.



The Coming Generational Storm — The Realities of America’s Economic Future

*Professor Laurence J. Kotlikoff
Chair, Department of Economics
Boston University*

During dinner, Professor Kotlikoff of Boston University’s Department of Economics conveyed the bad—actually horrific—and good news about the American economy. The bad news: the American government is going broke and it’s unlikely that appropriate measures will be taken to fix it. The good news: we can minimize the blow of this national predicament by taking advantage of certain financial measures—overviewed by Professor Kotlikoff—that are less susceptible to high taxes and inflation.

Professor Kotlikoff’s less than rosy outlook for America’s economy comes from research on demographics, and is elaborated in his recent book (with co-author Scott Burns) entitled [The Coming Generational Storm: What You Need to Know about America’s Economic Future](#). The authors describe how demographic trends in the United States will likely wreak havoc on the economy. The United States and other developed countries, along with developing countries such as China and Brazil, face rapid growth in the older population and declining growth in the younger population. The birth rate in these countries is well below the replacement rate of births per woman of reproductive age.

By 2030, 77 million individuals—the baby boomers—will be at retirement age in the United States. To provide a more visual perspective, Professor Kotlikoff and his co-author Scott Burns wrote, “You will see a country where walkers outnumber strollers. You will see a country with twice as many retirees but only 18 percent more workers to support them.” For example, by

2050, the centenarian population (individuals who are at least 100 years old) will exceed 600,000; this figure is roughly ten times the number of centenarians today. Living quarters for this group would require an area roughly the size of Washington D.C. In just thirty years, 19.4 percent of the U.S. population will be 65 years of age or older.

What exactly do these demographic figures mean for America's economic future?

As 77 million baby boomers move into retirement, they will begin to capitalize on Social Security, Medicaid, and Medicare. The total expenditures for these programs will be roughly \$43 trillion. While obviously a large number, why should this figure scare us?

An unreleased 2002 report conducted by statisticians, economists, fiscal analysts, and actuaries at the U.S. Treasury Department is believed to have been dismissed from publication from the President's FY 2004 budget due to possible backlash against President Bush's third tax cut. In the report, Secretary of the Treasury O'Neill and Dr. Kent Smetters calculated what's called "the fiscal gap—the difference, in present value, between the government's future expenditures and future receipts, assuming future generations are taxed at the same rate as current generations" (Kotlikoff and Burns, 2004:64). The fiscal gap was calculated to be roughly \$45 trillion. The Medicare drug benefit enacted in 2004 was expected to add another \$6 trillion, bringing the total fiscal gap to \$51 trillion.

Consider how we would likely redress this gap: by raising taxes. In order to address this whopping figure, Kotlikoff explained, the government could immediately: (1) raise federal income taxes by 69 percent; (2) increase payroll taxes by 95 percent; (3) cut federal purchases by 106 percent; or (4), cut Social Security or Medicare benefits by 45 percent. Given political pressures, none of these measures is likely to occur any time soon.



Professor Kotlikoff and Scott Burns have developed two plans related to Medicare and Social Security that, if enacted, could save our plight. Sadly, said Professor Kotlikoff, he has not received any phone calls from top officials related to their ideas. Therefore, individuals should very seriously contemplate their financial futures and begin planning now!

Now, the good news. Despite the forecast of a volatile economic climate in ensuing decades, Professor Kotlikoff believes there are ways we can take our financial future into our own hands. He explained that government bonds and 401(k) plans will not necessarily be the best investments due to the expected tax increases and inflation that will erode the value of savings. Instead Professor Kotlikoff suggests home ownership and non-traditional financial instruments, such as inflation-indexed securities.

Further, Professor Kotlikoff explained, traditional financial planning software has been misguided. Such packages require households to estimate their levels of saving and investment over time. Small errors in either savings or investment can cause dramatic under- or overestimates needed to maintain a high living standard. The software Professor Kotlikoff has developed, ESPlanner (see www.esplanner.com), offers an alternative to traditional financial planning software packages like Quicken. Using a patented algorithm, ESPlanner automatically calculates a household's highest living standards across time, as well as the saving and investment figures required to sustain living standards.

According to Professor Kotlikoff, the use of ESPlanner along with home ownership and non-traditional investment instruments are the best ways to minimize the risk associated with America's economic future.

Changing Board Requirements and Expectations— Implications for the CEO and for HR—Part II

*Mr. Roger Kenny
Managing Partner
Boardroom Consultants*

Roger Kenny, Founder and Managing Partner of Boardroom Consultants, an executive search and board consulting firm, spoke to HRPI members about CEO selection, evaluation, and challenges faced by boardrooms in today's climate. Further, he advocated that HR take on a more strategic role as a liaison between the board and management. He began his remarks by noting that boards are having difficulty adapting to their new roles. In order to contribute, they must understand an organization's strategy, risks, and competitive landscape. By doing so, they can aid management's strategic decisions.

Roger explained that boards need assistance, both from management and from human resource professionals. "We're in transition," he explained. Boards "need to know the rules of engagement. There's a need for facilitation. There's a need for someone to help them in a number of ways." For example, boards need information and dialogue in order to provide governance and advice. They cannot aid strategic decision-making if they are not provided enough of the right information, or if they lack partnerships with individuals within the organization.

Roger asserted his view that the need for partners to facilitate dialogue and information exchange can be met by an organization's human resources team. "This is a great role for HR... They want to feel your presence. They want a mentor. They want education." Usually, for example, newly hired directors are given a one-day session with a company's general counsel and a thick book of financial data. According to Roger, HR is in an excellent position to make new



director orientation more effective by providing a breadth and depth of information related to an organization's operations and management succession plan, and by acting as a liaison between senior management, the lead director, and the board as a whole.

Two areas of particular interest to boards that correspond to HR's expertise are succession plans for the CEO and top management and executive compensation. Directors fear the possibility of being on a board of a company under public scrutiny related to the CEO's compensation or a company without a CEO successor. "The last thing they want is to be on a board with a Grasso. They don't want to be in a Coke situation where there's no successor." A proactive and responsible board will want to hear from HR about possible successors' qualifications and will potentially want to meet with top candidates. Also, the board will benefit from HR's knowledge of the CEO and management team's respective compensation packages; it is of utmost importance that the board "feels comfortable with the connection between the CEO's compensation and that of the rest of management."

The HR team can fill a critical gap in board/management relations. Roger has never encountered a board that is entirely pleased with the company's strategy. This having been stated, the board often lacks information related to an organization's strategic plan or to senior management's perception of that plan. One of the lead director's primary responsibilities is to secure this information from senior management for the board's consideration and analysis. Further, the lead director, acting on behalf of the board, provides feedback to the CEO. Whether this is acted upon depends upon the CEO. In sum, Roger explained, HR can bridge the information gap between the CEO and senior management team and the board.

After outlining his key points, Roger fielded questions and inspired a general debate on several topics, such as board member selection and evaluation, how HR should position itself to become a liaison between the board and senior management, and the importance of gaining CEO support to implement an organization's succession planning program.

Selecting Board Members

One member asked Roger what criteria are most often used to select board members. Roger stated that the criteria are usually industry and company specific in that each organization operates in a unique environment. Some such criteria, depending upon the environmental context, could be a need for someone with deep industry knowledge, for global experience, or for exposure to growth through acquisition.

In order to meet these criteria, search firms are often engaged to locate the best talent within a specific or related industry. Identified candidates are gauged for their interest, references are checked, and interviews are conducted to locate the best candidate fit given an organization's criteria for selection. Boardroom Consultants, for example, has conducted numerous director searches for companies like Pfizer and Pitney Bowes.

HRPI Fellow Alan Lafley described his tenure with General Electric and Chase Manhattan Bank and his experience with three CEOs—one of whom was Jack Welch—to highlight the need of CEO support in succession planning. Alan stated that in his experience, although the company's most senior human resource executive will likely drive implementation of the succession program, the CEO is critical in initiating the process. If an organization lacks a supportive CEO, an effective succession plan is unlikely. Alan explained that at GE, with Jack Welch as its champion, he



successfully spearheaded a succession program that included extensive benchmarking and external candidate search.

Evaluating Director Performance

The group discussed criteria for evaluating director performance, including his or her attendance record, preparation for meetings, respect and consideration for other board members, level of contribution, and expertise. In terms of efforts to enhance group functioning, some boards include processes to allow each board member to assess other directors' performance, thus allowing feedback and ensuring that the most effective members stay and that those who are less so consider leaving their boards. Other boards have engaged in self-assessment of their processes, such as examining the way in which meetings are conducted, and considering whether suggestions from Human Resources and consultants related to compensation structures have been enacted.

HR & the Board

If HR is to take on the critical role as the liaison between the board and senior management, how should HRPI members posture themselves as good candidates? For example, one member stated that he would feel uncomfortable calling the board to offer support without CEO approval. Roger remarked that asking the CEO for his or her endorsement to take action on specific issues (e.g. offering opinions related to management succession, senior executive compensation) would be the one way to begin demonstrating the ability and inclination to serve as liaison between management and the board on a more general, ongoing basis.

Finally, HRPI members discussed the ambiguity surrounding management's and the board's mutual role in the process of corporate governance. "It sounds easy on paper," one



member noted, “but there needs to be dialogue” on both ends in order to meet both parties’ needs. Establishing these roles is a critical step toward effective governance.



Panel — Conclusions, Lessons and Next Steps

*Ms. Eileen Farrar
Senior Vice President, Corporate Human Resources, UnumProvident*

*Dr. Bruce Margolis, PhD
Executive Vice President and Chief Human Resources Officer, The TJX Companies, Inc.*

As the meeting headed toward a close, Eileen Farrar of UnumProvident and Bruce Margolis of The TJX Companies, Inc. led a roundtable discussion on lessons learned and next steps toward more effective corporate governance. As a starting point, Eileen spoke about UnumProvident’s historical and evolving relationship with its board of directors. Prior to the 1999 merger between UNUM Life Insurance Co. and Provident Co., Inc., making the company the world’s largest private disability insurer, Eileen served as Senior Vice President of Human Resources for UNUM Corporation.

Eileen explained that, at the time of the merger, UNUM’s CEO was “in a partnership with the board.” HR’s role was very direct and involved as the liaison between management and the board. When UNUM merged with Provident, it became clear that the two companies had divergent opinions about their respective relationships with their boards. The Provident board’s orientation was to support rather than question management’s decisions, with the CEO and Chairman driving much of the agenda. Two years after the merger, in response to company performance, Provident’s CEO was replaced by the board with an internal candidate.

Further, with the passage of Sarbanes-Oxley during that time, the relationship between management and the board was brought to the fore. Eileen explained her perception that the current CEO’s job is one of influence across the team (the organization) and to change a corporate

culture from one that is command and control to one that is more democratic and inclusive. Following the replacement of the CEO, the two outside directors were named co-chairs of the board. Between them, they are attempting to move to an objective, 360-degree feedback process for the board. Ultimately, these two events spurred a movement away from a non-cohesive board to one that is objective and focused on the business. The current CEO's role is much more one of influence with the board vs. directing.

Eileen then identified her greatest takeaway from the fall meeting: HRPI members are a good sounding board for each other in terms of sharing best practices related to changing board expectations. For example, each HRPI organization has likely identified best practices in the following areas: how CEO evaluation is done; how boards are selected and evaluated; how far down the board should go to identify successors and align compensation; and how to best expose management several levels below the CEO to the board. If the role of HR is to help influence objective approaches in these areas, the HRPI group would be a good source to document and share effective practices.

Next, Bruce summarized his major takeaways from the meeting. Boards, he stated, are critical to corporate governance. There are no obvious alternatives to board oversight. Further, the idea that directors, on average, spend 120 hours a year on board-related duties highlights the constraints they face when processing information and making appropriate decisions. "Boards are not necessarily high-performing groups, and are not necessarily open to changing processes." No certification practices exist with regard to board membership. Boards have not been created as a response to needs at companies. Neither their roles nor their relationship to management are clearly defined. These aforementioned reasons underscore why board governance can be a formidable challenge.



He reiterated the earlier discussion on how changing board expectations present an opportunity for HR. Can we, and how can we, influence board selection criteria as well as board processes? Can we influence the governance committee chairs toward effective group processes and outcomes? HR leaders would bring great knowledge as board members, particularly regarding executive development, succession, and business ethics, and would learn a great deal about governance which they could bring back to their own employers.

After Eileen's and Bruce's insights and takeaway remarks, HRPI members further discussed lessons learned and challenges going forward, and asked salient questions regarding changing board expectations and HR's evolving role. One member asked Eileen and Bruce whether their respective boards seem to understand their companies' strategies. Eileen responded that as UnumProvident has chosen and oriented new directors, it appears that the board is more closely reviewing and evaluating the company's strategy. Bruce stated that TJX has a very clearly defined business model and organizational culture. While the founder is no longer the CEO, he is still active as the Chairman of the board. Several members have been in their roles for a number of years, and, therefore, seem to have a firm understanding of the company's strategy and business model.

One member described how board members at his organization are less concerned with the strategy per se and more attentive to how it impacts financial indicators, such as earning per share and stock dilution estimates. This member opined that when board members do not entirely understand an organization's strategy, they may be unlikely to ask for elaboration for fear of appearing ignorant.

Another member described his organization as one in which the board governance process is well-established. To the founder's credit, this member noted, he established rules of governance, decision-making procedures, and other formal processes that aid effective outcomes. At another HRPI member organization, mediation and consensus among directors from different industries has proven challenging, as these directors bring perspectives that represent "different ways of looking at the world."

Orienting New Directors

What are best practices related to new director orientation? One member described an organization's recruitment of directors with global experience. The newly minted directors were given a large book of data and a one-day session with the company's general counsel. Given these directors' varying backgrounds (e.g. familiarity with British rather than the U.S. board practices, and with different accounting systems and regulatory systems), this orientation seemed sorely lacking.

Another member commented that at her employing organization, a website has been established for the board of directors. Directors are oriented and re-oriented without long-distance mailing of thick books of compiled information and are able to see past meeting presentations and minutes to get an historical perspective on the company. Other members indicated that their new directors are given tours of selected locations – such as plants and retail stores – in order to better acquaint the directors with the company's products and processes.

HRPI members discussed several other issues, including whether companies are publishing board of directors' e-mail addresses; how companies should respond when employees or a member of the public attempts to directly contact board members; how an individual's fame is to be judged as a criterion for board membership; whether lead directors are likely to be current or



retired CEOs; the process of using an executive search firm to locate and screen talented candidates for board membership; and the challenges of asking longtime directors who could be considered less than independent to step down.