

Harmonizing Goals of Outside Directors with Management Teams

On May 17, 2016, the Southern California Chapter of the National Association of Corporate Directors (NACD So Cal) held a luncheon event at The California Club in Los Angeles. Fifty-five people attended the event where Ron Sugar, Chairman Emeritus of Northrop Grumman (NYSE:NOC), shared his perspectives on aligning the goals of boards and management teams. Ron currently serves on four prestigious boards including Apple, Amgen, Chevron, and Air Lease Corporation. The fireside chat was led by NACD So Cal board member Rafael Pastor. Rafael is a seasoned board member serving on three international private equity boards, four for-profit boards, and three not-for-profit boards.

The following are 10 key takeaways from this informative and lively exchange:

- 1) In today's environment, directors must get three things right:
 1. Leadership – Directors are responsible for selecting the right CEO for the right time in the company's lifecycle and hiring or retiring a CEO if necessary.
 2. Strategy – Good directors must understand, challenge, adopt and improve the company's strategy.
 3. Risk – Directors must have a strong command of all compliance risks as well as enterprise risks to the business.
- 2) Although all of the above concepts should apply, a director's application of these ideas differs somewhat when it comes to public companies versus private entities.
 - In public corporations, directors are almost obsessed with the public nature of regulations, compliance processes, reporting, etc.
 - In private entities, directors are less concerned with optics and public perception, and can focus much more on creating value for owners.
- 3) Tension between fiduciary obligations and social responsibility has become one of the focal points of large cap corporate America.
 - In recent years there has been an increased focus on social responsibility.
 - With everything now so visible due to technology and media, people have begun to expect companies to do the right thing socially, not just financially.
- 4) Board diversity is critically important in representing shareholders.
 - Boards should bring diverse opinions, backgrounds and life experiences in order to determine what is in the best interest of the company and its shareholders, and ultimately the CEO has been selected to make these final decisions.

- 5) Not-for-profit boards:
 - Typically a not-for-profit board will be much larger than a for-profit company board for good reasons, including broader community reach and greater access to resources.
 - The best way to run a not-for-profit board is to have an executive committee with a lot of business experience within the board (a board within the board).
- 6) A best practice for boards is to frequently assess and discuss the following questions:
 - What is around the corner that we could be missing and are we allocating enough time to thinking about this?
 - What should we be doing to protect against threats to our business being cannibalized or killed?
 - How can we adapt and transform to meet potential challenges?
- 7) Boards and activists:
 - Fundamental defenses of an organization have been chipped away over the years.
 - Put yourself in an activist's shoes – if we were outside investors and we took over our company, what changes would we make?
 - Activists can have a multiplying effect and performance is the best defense. Put aside ego and engage with activists rather than going to war.
- 8) Management vs. board compensation and accountability:
 - Management compensation should be linked to company performance and shareholder return. Sale of shares should be restricted so that compensation is ultimately tied to the financial health of the company long term, thus creating long-term interest.
 - Board compensation is never commensurate with the challenges directors face. Directors should serve on boards because they feel it is their duty to do so.
- 9) Boards and management teams should not *a/ways* be in harmony. It is important for boards to be continuously challenging company strategy, but in an intelligent, constructive way.
- 10) Closing thought from the perspective of an enlightened CEO:

As a CEO you always want to leave the place better than when you came in, and with a team in place that can take the company to a place you never could have taken it if you stayed.