CORE
Metadata, citation and similar papers at core.ac.uk
Provided by eGrove (Univ. of Mississippi)

University of Mississippi
eGrove

Touche Ross Publications

Deloitte Collection

1980

New power of the nominating committee

Silas S. Cathcart

Follow this and additional works at: https://egrove.olemiss.edu/dl_tr

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation
Tempo, Vol. 26, no. 2 (1980), p. 49-51

This Article is brought to you for free and open access by the Deloitte Collection at eGrove. It has been accepted for inclusion in Touche Ross Publications by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

The New Power of the Nominating Committee

by SILAS S. CATHCART/Chairman, CEO, Illinois Tool Works, Inc.

The nominating committee has emerged as a powerful force capable of determining corporate direction.

Why has this happened? A number of key developments has recently changed the role of the board of directors, setting the stage for the emergence of the nominating committee. Some developments have been legislative, such as the Foreign Corrupt Practices Act of 1977, which requires directors to oversee their companies more closely for possible illegal payments. Lawmakers such as Senator Howard Metzenbaum of Ohio even have talked about legislating standards of conduct for directors, and Ralph Nader has his Corporate Democracy Act.

Regulatory actions, principally by the SEC, have had even greater impact. Pressure for more participation on boards by outsiders and stepped-up investigations of negligence or misconduct by directors are two primary examples of SEC activity in this area.

Equally as important as regulatory and legislative pressures has been the litigation against directors by shareholders. A national insurance brokerage firm reports that the number of claims against corporate directors has increased 300 percent in the five years since the *Penn Central* cases were settled. Of the top 1,000 corporations in the U.S., 95 percent now carry liability insurance for directors and officers. Five years ago the figure was only 60 percent.

Understandably, the combined effect of all these external influences has been to alter significantly the way boards function and how board members view their jobs. One clear trend has been a greater involvement by outside directors. A recent study conducted by Korn/Ferry, an executive placement firm, indicates that, as of 1979, the average board consisted of four inside and nine outside directors. What's more, 75 percent of the directors surveyed felt that outsiders should outnumber insiders in the boardroom. That represents a trend, incidentally, with which I agree.

Indeed, I am convinced that further legislative and regulatory restrictions on board members can be prevented only if we actively support the appointment of outside directors as a means of assuring an independent board. The corporate community's voluntary agreement to the call for greater board autonomy and increased corporate governance is far more constructive than would be increased governmental regulation. It offers far greater benefit to business, to shareholders, and to the taxpaying public.

A second trend, which is basically a response to the increased responsibilities that a board must bear, is the emergence of the committee structure. A strong committee structure takes advantage of individual expertise, allows more deliberation of issues apart from meetings of the entire board, and permits better use of the board members' limited time. The increased use of committees in and of itself, however, is not enough. Committees must be given specific and rather narrow charters, and we are seeing the first emergence of such duties as setting objectives, formulating and approving strategies to achieve these objectives, evaluating overall performance, and selecting, motivating, even firing the chief executive officer.

Probably the first committee to be used widely was the audit committee, which is usually composed of

The New Power of the Nominating Committee

outside directors only. This committee took on added significance with the New York Stock Exchange requirement of 1978. Other committees that have emerged cover such areas as executive, budget, finance, executive compensation, public affairs, and planning.

The nominating committee is a relative newcomer to most boardrooms, at least in the format that it is taking today. Interest in the nominating committee, which really began in the early 1970's, grew tremendously by the end of the decade. In 1979, the previously cited survey of corporate boards found that 37 percent were using the nominating committee as a standing committee. Just a year earlier, the response was only 10 percent. In companies with sales over $1 billion, the 1979 rate was 50 percent, up significantly from the 38 percent just a year earlier.

The same 1979 survey also showed that of the 50 percent not using nominating committees, 16 percent, about a third, planned to establish a nominating committee within the next year. Companies which already had such committees, the study found, said they would use them more.

These statistics indicate that the nominating committee is here to stay. The reason, it seems to me, is clear. Identifying and attracting quality outside directors—the committee's primary function—has never been more critical than it is today. I will come back to this important area, but first let me focus on the additional functions of the nominating committee that many people see emerging.

One question they raise about the nominating committee is whether it should be involved in the management succession process. The nominating committee screens candidates for the chairmanship or presidency, but, increasingly, it also examines candidates for other high-level management jobs. The general objective of the management succession process is to assure a smooth and timely transition when the need for new leadership arises. Some boards have concluded that this responsibility fits naturally within the scope of the nominating committee.

A related function of the nominating committee, some say, might be to monitor management performance and to recommend changes in management structure. Suggesting the appropriate size of the board could be another. In addition, nominating committees increasingly are recommending the functions of committees and determining their memberships. Finally, nominating committees are prescribing how frequently meetings should be held, as well as where—the corporate boardroom, a major manufacturing facility, or, on occasion, a foreign location.

Now, these are all important factors that can determine the overall effectiveness of a board, and they should be considered carefully. However, I take exception to the notion that a nominating committee should be chartered to do all of these functions. I believe that the nominating committee should be concerned with the selection of board members, the proper size of the board, the frequency and location of meetings, the proper committee structure, and the membership of those committees.

I do not believe that the duties and interests of the nominating committee should be focused on management oversight, management succession, or management structure. These are very different issues and, it seems to me, should be the concern of either the board as a whole or—in keeping with my earlier remarks regarding narrow charters for committees—possibly the concern of a separate committee. If we were talking about a separate committee for oversight and succession, it most probably should be composed of board members who are CEOs from other companies, because people with the background and experience of a CEO are accustomed to and comfortable with selecting and managing business people. This is their expertise.

Let's take a look at the survey I mentioned earlier and at what it revealed about committee membership. Typically, the nominating committee consists of seven members, four of whom are independent outside directors, including a banker, legal counsel, or retired manager, and two of whom are inside directors, usually the chairman and president. Significantly, the survey found that 37 percent of companies with nominating committees had no inside directors at all.

In some cases, the board chairman is placed in charge of the nominating committee, but this approach has been debated. Opponents claim that the chairman's dual role tends to negate the objectivity ostensibly present in the committee and the transfer of authority. Proponents argue that the chairman should make suggestions to the committee and coordinate its activities.

I side with the view that the membership of the nominating committee should be exclusively from the ranks of the outside directors. Only in this way can the charges against the CEO of stacking his board be neutralized. If the CEO is an ex officio member or participant, that is fine, but he should not be a member.

Regardless of how the nominating committee is structured, its fundamental duty—finding new board member candidates—is getting a lot tougher. The Korn/Ferry survey of

corporate boards showed that more prospective directors turned down otters to serve in 1979 than in any of the prior seven years. Of the firms surveyed, 13 percent had at least one candidate turn them down. A well-known, prestigious corporate name did no prevent this phenomenon either. The 128 firms surveyed, which had sales over $1 billion, experienced a turndown rate that was three times that of 1978.

The way the nominating committee goes about the critical job of selecting candidates and getting the acceptances of its future board members is a vital assignment. The committee has to be sure that various constituencies are represented and yet do not upset the balance of viewpoints on the board as a whole. As more minorities, academicians, and representatives of various social concerns become board members, the manner in which the committee is structured—the nature, breadth, and objectivity of the candidates that satisfy these needs—will be critical to the future direction of the corporation.

What all this says to me is that the nominating committee is an increasingly important part of the corporate world. At present, and hopefully in the future, it can be viewed as a means by which the corporate world can deal voluntarily with some of the major criticisms being leveled at it.

In short, our boards are responding to the reasonable demands for accountability from a variety of constituencies. And the nominating committee's efforts to help the corporation balance the needs of shareholders, employees, and the community is squarely in the middle of this action. It is a tough and pivotal middle, in fact, and perhaps the fulcrum on which will turn the corporation's future course of action. △

Notes from the Boardroom

by RODERICK M. HILLS/Former Chairman, SEC

The following excerpts are from a presentation made at a Houston directors' seminar by Mr. Hills, a partner in the law firm of Latham, Watkins & Hills.

I first joined a company that had directors and stockholders back in 1960. It was a small electronics company, and as I walked into the room, I saw an older gentleman sitting at the table. He was obviously a veteran of these meetings, and I said to him, kind of shyly, "What is it that we're supposed to decide here?" He said, "Well, Sonny, you come into each board meeting, and you just ask yourself one question: Should we fire the boss? If the answer turns out to be no, just keep your mouth shut, and smile a lot."

Today, we're asked by the law to make a lot more decisions. But I seriously question whether any of these mandated decisions are helpful to the primary mission of directors, which should be the corporation's productivity and profitability.

As a director, it is my responsibility to know what the other directors bring to the table. Is there sufficient experience in the group to provide an overview for this company? By reason of background, training, knowledge, intelligence, does this group have the minimum ability needed to judge the business? I didn't choose them. Probably the president did. But isn't it my responsibility, the board's responsibility, to look around each year and decide? And that evaluation should be done, it seems to me, before the old slate is renominated just on the grounds that we all play golf together a couple of times a year.

One day some judge is going to proclaim in a learned opinion whether or not a board has a sufficiently independent character to make the decisions a board needs to make. If he's my kind of judge, he won't much care whether there is a given number of outside directors and so many inside directors. He won't very much care whether there is a nominating committee or what the board's structure is. What will matter is that there is real independence, and that it is being exercised to decide whether to reject a tender offer, to go private, or to approve a company's pricing mechanism.

Rather than have the SEC tell us how directors should act, the courts can cause this standard of independence to evolve, based on practical experience and proper corporate performance. The judicial role—so played—will be to bring the more deficient companies up to that standard. That, after all, is how the common law evolved in this nation. △