A Field Guide to the Modern Corporation and its Board of Directors

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Who owns the business?

- In most cases the answer is that a corporation owns the business
- Corporations are artificial beings that the law generally deems to have legal personality
- Unlike human beings, corporations have no body or mind
- In legal terms, however, corporations are very close to being real people
- In Canada, a large proportion of corporations are governed by the Canada Business Corporations Act ("CBCA" or the "Act")
- The Act states that "a corporation has the capacity and, subject to this Act, the rights, powers and privileges of a natural person"

How does a corporation work?

- The mind and body of corporations are supplied by people who play various roles. The law organizes these roles in a way to breathes real life into the corporation
- The most important roles are
  - Shareholders
  - Directors
  - Officers
- The remaining roles that are vital to the corporation's ability to carry on business are
  - Employees
  - Suppliers
  - Customers
  - The public
- Together these 7 groups are often referred to as "stakeholders"

The role of shareholders

- Shareholders collectively own the corporation but they do not run it. They are the ones who elect the directors
- Directors collectively supervise the running of the corporation, most often they do not own much of it
- Officers run the corporation and steer the course laid out by the directors, most often they wield the most real power

The role of directors

- The CBCA says that "the directors shall manage, or supervise the management of, the business and affairs of a corporation"
- We'll come back to this because this is where we are going to focus

The role of officers

- Officers are the corporation's brain
- An officer is a person appointed by the Board of Directors to run the corporation's business
- Such persons traditionally had titles like "president", "treasurer" and "secretary"
- The Board of Directors most often appoints a single person as the most senior officer whose role it is to supervise everything and everyone else. This person is usually referred to as the Chief Executive Officer or simply "CEO"
- The CEO surrounds herself with other officers that the Board of Directors usually appoints based on the CEO's advice. These "second tier" officers usually (but not always) have the word "Chief" in their title. The word "executive" is also popular as in "Executive Vice-President". The second most important "chief" officer of most corporations is the Chief Financial Officer or "CFO". There are many, many others

The role of other stakeholders

- Employees
  - These are the legs, arms and mind of the corporation, the unsung heroes, the good the bad and the ugly. These are the folks who actually get things done
- Suppliers
  - Before most corporations can actually have a business, they need suppliers. Suppliers provide things like premises out of which to work, phones and computers, inventory and all the other things that the business can't easily do without
- Customers
  - In the past, customers were the last link in the chain. They consume the goods and services the corporation produces. The money they spend is the corporation's revenue (often referred to as the "top line"). Once all the other stakeholders have been paid for their services, the money left over makes up the profit (often called the "bottom line") which the Board of Directors either decides to leave in the bank, plough back into the business or divide up amongst the shareholders (hence the word "dividend"). Often the Board decides to do a little of each of these things, to make everyone happy.
  - The customers used to be the last link in the chain… today, there's another

The role of other stakeholders - Continued

- The public
  - As technology shrinks the world (not only the Internet, but container shipping and air transportation too) corporations grow in social and political importance. In 2001, of the world's 100 largest economic entities, 51 were corporations and 49 were countries. Things that corporations do often have more impact on the quality of people's lives than the things that many governments do
  - Corporations therefore increasingly attract public attention. When the attention is good (*The I-Phone is soooooooooo cool!!*) shareholders, directors and officers swoon with pleasure and pride. When the attention is bad (Bhopal, Exxon Valdez, Enron, WorldCom, sub-prime mortgage messes…) it gets very nasty, very fast. Officers are particularly susceptible to reacting poorly to bad news. Why?
  - This brings us back to the Board of Directors…

The role of the Board of Directors - Continued

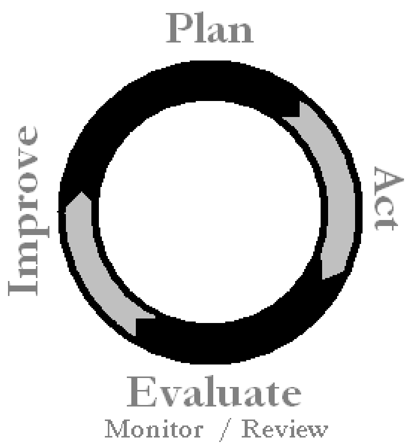
- Now that we have a very basic understanding of where the Board of Directors fits in as one of the 7 stakeholders, we can explore its role in more detail in order to understand what it must do and how it works
- The shareholders elect the directors, and the directors appoint the officers. One could conclude that the shareholders have the most power and the officers have the least of these three. The truth is that the power equation at the summit of most companies is far, far more complex and more subtle than the simple legal roles would lead you to believe
- For instance, the shareholders usually only get to elect the directors that the directors propose for election. Does this make the directors the most powerful of the three top stakeholders?
- In practice, it is the CEO (she usually is also a director) together with the Chairman of the Board of Directors (usually the "dean" of the directors) who set the agenda for the Board of Directors. The CEO in the past was often the person who suggested the persons who should be proposed for election as directors. Often today, especially in the US, the CEO is also the Chairman of the Board. Does this mean that the CEO is the single most powerful person in the corporation?
- The answer is legally "no", since the Board of Directors appoints the CEO, but since the CEO has so much influence at the Board level, the answer is often "yes"

The real role of the Board of Directors

- The truth is that the Board of Directors and the CEO are tightly bound together in a complex mix of legal authority, political power and influence in which there is a lot of dialogue and give and take. It's basically comparable to a high-stakes balancing act
- The single most important decision that a Board of Directors must make is who is to be the CEO. Once that decision is taken, the Board of Directors generally gives the CEO as much leeway as possible in the hope that she will run the corporation's business in a way that will earn fat profits and bring plenty of good news, so that the corporation and the Board of Directors will be able to bask in all the reflected glory and shareholders will be happy
- In the meantime, while the CEO is hard at work making business magic happen, the Board of Directors plays a monitoring role. A little like the good father who has entrusted the family business to his eldest son
- But the Board of Directors also has other duties. Because the law places the entire legal burden of managing the corporation on the directors, the directors must act in the best interest of the corporation at all times
- In this regard the Act says that directors must "act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances"

The real Board of Directors role: Leading, Supervising, and the Obligation of Diligence

- On the following slides we'll explore in even more detail the principal roles that the Board of Directors plays
  - Leading and Strategic Direction
  - Financial diligence and reporting
  - Environmental diligence and reporting
  - Decision-making and delegation of authority
  - Succession planning
- Think of this as a cycle



Leading and Strategic Direction

- The selection and appointment of the CEO is pretty much where the Board's cycle of responsibilities kicks off
- As noted earlier, the Board of Directors fulfills most of its leadership role by selecting the CEO as the one person on whom they pin the corporation's hopes and dreams. When there is no successor in play, the directors will usually turn to an executive recruiting firm to identify potential candidates and submit the best of them to the Board of Directors for consideration
- Once a selection is made, the winning candidate will be appointed to the CEO position by the Board of Directors
- If the company is in start up mode, they will then turn to the CEO and ask him to assist in the recruitment of the other senior executive officers
- Once the key leadership personnel are appointed, the Board of Directors next turns its attention to strategic planning
- The CEO will be asked to present a strategic plan and operating budget for the first years of her mandate as CEO
- The strategic plan and operating budget are thereafter approved on a yearly cycle, usually just before the ensuing fiscal year of the corporation

Financial diligence and reporting

- Once the executive officers are in place and the strategic plan and budget have been approved, the Board of Directors turns its attention to its monitoring and reporting role
- The monitoring and reporting role is one of reasonable diligence. Here the Board of Directors, usually relying on the Chief Financial Officer, establishes internal control and financial reporting structures that are the building blocks on which the financial statements are prepared
- At least quarterly, and when there is more risk, sometimes monthly, the CEO and CFO attend at Board of Directors meetings and present the results of operations. The Board of Directors reviews the results carefully, always mindful to obtain reasonable assurance that:
  - The results are in line with the expectations set out in the budget; and
  - The financial statements present accurately the true financial status of the corporation's business and affairs
- As part of its financial diligence and reporting role, the Board of Directors will normally receive reports on all the ancillary matters that are normally reported on in the financial statements and public disclosure documents (the status of litigation and claims, sales and marketing activities, employee and customer satisfaction, quality programs, availability of credit facilities, etc., etc.)

Environmental diligence and reporting

- Environmental diligence and reporting is a subset of financial diligence and reporting
- It deserves a separate topic simply because the environmental laws often impose liability on directors personally when the corporation breaks environmental rules
- This is a serious source of concern for directors who serve on the Boards of Directors of resource, pharmaceutical and other companies with environmental exposure so they set up special diligence programs to make sure that the corporation is always complying with environmental laws wherever it operates

Decision-making and delegation of authority

- The CBCA (remember the "Act"?) places all decision-making authority squarely with the Board of Directors
- This means that all corporate action, from making a major acquisition, down to purchasing pencils, must be authorized by the Board of Directors
- The Board of Directors' decisions take the form of *resolutions*
- Resolutions are either specific ("THAT the President be authorized to purchase 15 HB pencils for the corporation's use…") or general in nature
- Because the Board of Directors works at a very high level, corporations sooner or later adopt a general delegating resolution that empowers the officers and rank and file staff to make decisions, represent and act on behalf of the corporation for what lawyers like to refer to as "the ordinary course of business"
- The Board of Directors typically retains authority for major strategic decisions and very large transactions
- For that reason, the CEO must obtain permission from the Board of Directors before embarking on major acquisitions and other matters that the Board of Directors considers to be of major importance

Succession planning

- After many years (in some companies 5 years is many years) of successful operations and fat profits without incident and without financial or environmental scandal, the CEO, who has done such a commendable job, is getting long in the tooth
- The Board of Directors must then begin worrying about his successor
- This process is rarely (though sometimes is) left to the end when a crisis looms
- The prudent Board of Directors reviews and approves a succession plan annually, to be ready just in case the executive jet crashes
- A succession plan is usually also in place for the Board of Directors
- Once a succession does takes place, the entire cycle begins again, with the Board of Directors returning to its leadership and strategic direction role

How does the Board of Directors get all this done?

- Standing Committees are key
  - With the breadth of scope and daunting detail that the Board of Directors must oversee, it cannot hope to get all its work done in a committee of the whole
  - Specialized committees are therefore set up
  - The usual committees one encounters are
    - The Audit Committee (this is required as a matter of law for public companies)
    - The Corporate Governance committee (also required for public companies)
    - The Human Resources committee
  - Other committees are sometimes added, depending on the nature of the corporation's business, or to handle special projects
- The charter or mandate of the Board of Directors and its committees are also key
  - The Board of Directors (and each committee) often adopts a charter or mandate in which it carefully considers the things it needs to concern itself with and commits them to writing

How does the Board of Directors get all this done?

- The work program
  - Once a charter or mandate is in place, a work program is prepared that allocates all the work that is needed to be done to fulfill the mandate among the regularly scheduled meetings
- The meeting calendar
  - The meeting calendar sets out the number of meetings needed to comply with the work program
  - A public company's Board of Directors must meet at least once each quarter in order to review and approve financial statements
  - More meetings (or fewer meetings, in the case of private corporations) are planned depending on the work program

How long does it take?

- The average Board of Directors or audit committee meeting lasts approximately 5 hours
- Other committee meetings run approximately 2 hours each
- The Board and its committees typically meet once each quarter, plus one to three additional scheduled meetings, plus one to three special meetings, which means on average about 8 sets of meetings each year.

Who are these directors?

- Directors of public companies are usually sitting or retired CEOs from other companies, current or former senior executive officers, influential former politicians, senior academics, or senior subject matter experts such as lawyers, accountants and others

How much does this cost?

- This is only relevant for a public company
- Directors' compensation:
  - outside independent directors that must be elected to a company's board are remunerated typically with
    - Directors' fees comprising either all-in-one-fees or a combination of annual retainers and per meeting fees
    - They also are reimbursed for out of pocket and travelling expenses
    - Some form of equity participation is offered and is mandatory (usually shares, share units, stock options, etc., etc.)
- The direct and indirect total cost ranges from approximately $500,000 to $2,000,000 or more, depending on the corporation, the size of the Board of Directors and the frequency of meetings
- Based on a minimum of 7 sets of Board and Committee meetings per year, the cost per meeting hour ranges from $7,000 to $20,000 or more

So what conclusions can we draw about Boards of Directors?

- They are staffed by very senior VIPs
- They cost a lot of money to run
- They have relatively little time in which to do their work
- The topics they must deal with are complex and fraught with risk and serious consequences for all concerned
- The law imposes heavy obligations on directors in terms of personal liability and duties of care and diligence
- The CEO who is everyones ultimate boss, is also a VIP, and knows that his fate ultimately rests in the Board of Directors' hands
- So the bottom line is that the modern Board of Directors meeting is a very serious place where the stakes are sky high and time is at a serious premium
- No wonder people get nervous when they have to make a presentation to the Board of Directors

How does the role of the Board of Directors relate to corporate communications?

- Corporate communications is all about moving information in an effective and efficient way among the various stakeholders
- The Board of Directors is the ultimate source of decision-making in a corporation. Because of this role we find that:
  - Information flows to the Board of Directors
  - Information flows from the Board of Directors

Information that flows to the Board of Directors

- Operations reports
- Financial reports and corporate disclosure documents
  - Press releases
  - Securities disclosure documents
    - Financial Statements (quarterly and annual)
    - Management's Discussion and Analysis ("MD&A")
    - Annual Information Form ("AIF")
- Audit Committee reports
- Corporate governance committee reports
- Human resources committee reports
- Reports from other standing or *ad hoc* committees
- Investor relations reports
- Materials relating to transactions or new strategic directions that require Board of Directors approval

Information that flows from the Board of Directors

- Typically, this takes the form of resolutions which are legal documents that provide evidence to third parties of decisions that the Board of Directors has taken
- Resolutions are highly technical documents that are intended to have precise legal effects
- The resolutions are carefully crafted to manage risk by ensuring that only the matters specifically approved by the Board of Directors are acted on

Who channels the information to and from the Board of Directors?

- The senior executive officers that the Board of Directors have appointed are responsible for ensuring that the information that the Board of Directors requires is provided in a timely manner
- In practice the presentations to the Board of Directors are done by more junior persons who report to the senior executive officer and who have subject matter expertise
- These types of detailed reports are most often submitted at the committee level (Audit Committee, Human Resources Committee, Corporate Governance Committee, Pension Committee, Investment Committee, Risk Management Committee, etc.)
- At the Board of Directors level, with the exception of special business (large transactions, decisions of strategic importance, etc.), information typically flows only from the CEO, the CFO and the committee chair persons

So where does the communications professional fit in?

- The most senior executive officer responsible for the communications function often reports directly to the Board of Directors on the subject of investor relations
  - Who are the corporation’s major shareholders?
  - Are there trends or shifts in shareholder demographics?
  - Have any new large shareholders emerged?
  - What are their concerns?
- The most important role, however, is an indirect role

The true role of the communications professional – outbound information

- The Board of Directors operates at a level that most employees never witness and at a level of abstraction and complexity that most employees will have difficulty understanding
- Yet it is of vital interest to the Board of Directors that the policies it adopts and the decisions it makes

    to manage risk

    to delegate authority

    to disclose information to the corporation's shareholders and other stakeholders

  are disseminated to those stakeholders accurately, simply and in a manner that ensures that the intended message is appropriately conveyed
- The communications professional works closely with the key senior executive officers to ensure that the Board of Directors' policies and decisions are conveyed effectively

The true role of the communications professional – inbound information

- At the Board of Directors level, the key input of the communications professional is crafting effective press releases
- Press releases are the principal vehicle that Boards of Directors must use to communicate key decisions to the public
  - Usually these are financial reporting press releases
  - For large transactions, the press release announces the transaction and provides vital information that the financial community needs in order to assess the importance of the transaction accurately
- The remaining role vis-à-vis the Board of Directors is indirect and involves providing support to the senior executives who propose corporate action to the Board of Directors to ensure that there is an effective communications plan in place ensuring that the decisions ultimately made will be implemented accurately, efficiently and in keeping with the Board of Directors' expectations

Questions?