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**A**credula is the Latin word for “owl,” connoting wisdom. This newsletter is intended as wise counsel for boards and executives. Acredula is available to clients and friends of the firm. It is not to be construed as legal advice or opinion.

## Advocacy of the “Expertise” Board

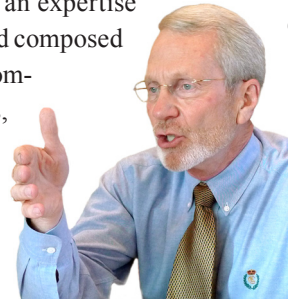
I was recently introduced as a “leading” advocate of an “expertise” board. I guess I am pleased to be described as “leading,” because “lagging” probably would connote that I am deceased!

I am delighted that the concept of an expertise board is becoming known: A board composed of persons each having particular competencies (i.e., knowledge, skills, experience, and expertise) needed for the board to have as a whole all of the competencies necessary to achieve its future objectives. This is in contrast to a “constituency” board which is composed of persons who represent the view of a particular constituency (such as the US Congress or a state legislature).

In this issue, we advocate “The Case for the ‘Expertise’ Board: Selecting Board Members on the Basis of ‘Competencies’ rather than ‘Constituencies.’”

Although “words are my business” now, many do not know I have a background in mathematics and

statistical analysis. I conducted public opinion polls and focus groups before practicing law, and I have continued to review and extrapolate the empirical data from such polls and groups to the present day. I believe that both existing law and changes in law should be supported by empirical data.



**COMMENTARY**  
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So “The Case for . . .” article begins with empirical data supporting the expertise board. It then discusses basic tenants of corporation law also in its support.

I passionately believe that governing boards are not only the first line of defense against mismanagement and fraud, but also the best line of offense for good governance. Recent failures over the last dozen years show that all organizations can do a better job selecting their board members. Doing so, upon the basis of the collective expertise and competencies of the board as a whole, may reinvigorate confidence in corporate America.

## The Case for the “Expertise” Board: Selecting Board Members on the Basis of “Competencies” rather than “Constituencies”

Empirical data from a number of sources, including surveys of board members, blame the recent failure of the financial institutions on the lack of expertise and other competencies of

their boards to understand the business model and strategic direction of their organizations. The purpose of this article is to discuss (i) the concept of an “expertise” board selected on the

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basis of their members’ collective competencies and (ii) the empirical data and basic corporate governance tenets supporting such a selection.

**Concept of the “Expertise” Board**

An “expertise” board is a concept described by Peter Larson, former chairperson of Brunswick and member of Compac’s board, as part of a conference held at the Fisher College of Business of The Ohio State University on “Building Better Boards” in September 2000. An “expertise” board is composed of persons each having particular competencies (i.e., knowledge, skills, experience, and expertise) needed for the board to have as a whole all of the competencies necessary to achieve its future objectives. This is in contrast to a “constituency” board, which is composed of persons who represent the view of a particular constituency (such as the US Congress or a state legislature).

Unlike a constituency board, assembling an expertise board requires an organization to assess the core competencies present among the members of its board and management team; to prioritize the additional competencies necessary for its future strategic direction; and to recruit persons having those competencies for nomination as board members. (For reasons discussed below, an organization and its board must first agree upon the organization’s future strategic direction before determining what competencies may be beneficial).

Simply stated, an expertise board is chosen based upon the collective competencies of the board members to act in the best interests of the organization as a whole rather than upon the basis of the views or interests of any of its separate constituencies in particular.

Accordingly, the major benefit of an expertise board is a focus on the best interests of the organization as a whole because its members are selected on the basis of their collective competencies to act in those best interests. Expertise boards also avoid problems of a constituency board whose members view

their duties as representing the best interest of the separate constituency that each member represents, often resulting in:

- Partisanship similar to Congress and state legislatures;

- Decisions watered to the least common denominator; or
- Favoring particular constituencies rather than the organization as a whole.

**Empirical Data Supporting Expertise Boards**

Recent empirical data regarding factors contributing to the current Great Recession support an organization’s selecting its board members on the basis of the competencies.

In 2009, the faculty of Harvard Business School’s Corporate Governance Initiative interviewed 45 board members of financial institutions and similar complex organizations contributing to, or affected by, the credit crisis and subsequent recession. “Perspectives from the Boardroom – 2009” is a paper written by Jay Lorsch of the faculty.

According to the paper, the two contributing causes most frequently cited by the interviewed board members were:

- The lack of guidance given to the boards and its members as to the role of the board and each of its members with respect to management of the organizations; and
- The lack of understanding by the board of the business model and strategic direction of the organization.

With respect to the role of the board and its members, the paper states:

Directors’ reflections on the board’s role had multiple dimensions. For some, the question was whether and how exclusively the board should focus on compliance with applicable laws and regulations. In their view, the board’s primary role is to be rules-oriented. Others viewed compliance as the job of lawyers and conceived of the board’s job much more broadly. “I’m more comfortable on some boards than I am on others,” one director told us. “Some people have really taken the value of governance, the importance of governance, to heart, and it pervades the company. Others have been slower to that realization, and tend to view governance as something that the lawyers are driving. And therefore it is something that, at the attitude level, slows things down; it’s a cost to the enterprise. It gets in the way of being efficient about decision-making and moving forward.”

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According to the paper, the thoroughness of the board’s “understanding” of the organization was second only to the issue of the board’s role in frequency of references during the interviews. The paper uses the term “understanding” because it expresses what the directors seemed to be seeking. The paper’s most definitive statement is a quote from one of the interviewed board members:

“My experience is that it’s of utmost importance that the board has a full understanding of the business model . . . entry barriers, competitors, technological changes and so on. A full understanding of the business model—which includes, of course, what are competitors doing, what are the trends in the market and so on.”

The March/April 2009 issue of “The Corporate Board” contained observations by Gordon R. Caplan and Andrew A. Markus with Willkie Farr & Gallagher LLP in an article entitled “Independent Boards, But Ineffective Directors,” including the following: “Sarbanes-Oxley . . . shifted director-level attention away from the primary board function of oversight and strategic direction . . . [to] disclosure . . . and detail of accounting and legal compliance. This has created a class of ‘professional’ directors [who] know some of the law and some of the accounting rules, but often do not fully understand the fundamentals of the businesses they are supposed to be overseeing.”

Finally, the SEC obviously is seeing the same or similar empirical data. In December 2009, the SEC amended Regulation S-K that sets forth the requirements for disclosure in proxy statements of publicly traded companies to require discussion briefly of “the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director for the registrant at the time that the disclosure is made, in light of the registrant’s business and structure.” While the SEC is not directly advocating that publicly traded companies have an expertise board, the SEC is requiring disclosure of information that will allow a shareholder, as well as potential investors, to determine whether the company has an expertise board.

The SEC also is requiring disclosure of “the extent of the board’s role in the risk oversight of the registrant.” Again, the SEC is not directly advocating that the boards of publicly traded companies oversee risks, but it is requiring disclosure of information that will allow a shareholder, as well as potential investors, to determine whether the company’s board does so. If so, experience or other competency with the enterprise risk should be a qualification, attribution or skill being considered by the board in determining its composition.

### Basic Tenets of Corporate Governance Supporting Expertise Boards

A basic tenet of corporate governance in all 50 states is that the board is the highest management authority of a corporation in that all of the authority of a corporation shall be exercised by or under the direction of its directors. A related basic tenet of corporate governance in all 50 states is that a board exercises that authority and otherwise acts only as determined by a majority vote of its members

Other empirical data from which similar conclusions can be deduced is a survey by Bricker & Eckler LLP of the composition of the boards of failed financial institutions in terms of the board member’s principal occupation. Below are summaries of the boards of three institutions:

- *Institution A:* 2 insiders (CEO and SVP); CEO of a museum; CEO of a hotel chain; CEO of a brewing company; CEO of a cosmetics company; CEO of a media company; CEO of a wealth advisor; CEO of an electronic company; former diplomat of the U.S. State Department; and Professor of economics

- *Institution B:* 1 insider (CEO); retired CEO of an auction house; retired CEO of an electronics company; CFO of an theatrical company; retired CEO of an oil equipment company; retired Admiral of the US Navy; retired CEO of a national bank; retired CEO of a broadcasting company; retired CEO of an investment banking firm; and retired CEO of an import-export bank.

- *Institution C:* 3 insiders (CEO and Co-COOs); two presidents of universities; CEO of a toy company; CEO of a petroleum company; CEO of a wireless provider; CEO of a media company; and CEO of an industrial company.

While these boards had impressive pedigrees, they were dominated by CEOs. These pedigree boards were missing board members with competencies in law, accounting, economics, business modeling, *et al.* to ask questions, most importantly “what if things don’t go as expected?”

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at a meeting at which a quorum is present. The combination of these two basic tenets assumes that an organization’s board, or at least a majority of its members, should understand the organization’s business model and agree to the organization’s future strategic direction.

An organization cannot select board members on the basis of their collective expertise and other competencies to achieve the organization’s future strategic direction unless first there is an agreed strategic direction.

Another basic corporate governance tenet in all 50 states is that each director of a corporation has a duty of care to act with the care that an ordinarily prudent person in a like position would use under similar circumstances. A related basic tenet of corporate governance in most states is that a director, in performing his or her duties, may rely upon one or more other directors reasonably believed to be reliable and competent. This basic tenet assumes that, at a minimum, each director should

reasonably believe that the director either alone or together with other directors understands the organization’s business model and agrees to the organization’s future strategic direction.

### Structure Follows Strategy

My colleague, Kevin Kinross, has long advocated that structure, such as board composition, must follow strategy. “Structure follows strategy.”

## Structure Follows Strategy— The importance of having a developed strategy to drive the Board’s composition



By  
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To adapt to the ever-changing environment in which they must operate today, corporations, both for profit and nonprofit, need to remain flexible—this includes flexibility in an organization’s strategy, its market, its workforce and even its board. This ability to be flexible is one key indicator of a high-performing board and makes board composition more important than ever.

Boards need to remember one theme while planning and structuring the board’s composition: Structure Follows Strategy.

Organizations need to value every seat on the board of directors and recognize that each seat represents an opportunity to increase the organization’s expertise.

An organization cannot select board members on the basis of their collective expertise and other competencies to achieve the organization’s future strategic direction unless first there is an agreed strategic direction. Kevin and I find that the best method for a board to view its own expertise and competencies is to for the board to do so as part of the strategic planning process by determining:

- First, the future strategic direction of the organization; and
- Then the particular expertise and other competencies needed for the board to have as a whole all of the expertise and competencies necessary to achieve these that direction.

We believe involving a board in determining the future strategic direction of the organization and then the particular expertise or competencies needed to achieve future objectives will result in refreshment of the members of the board without relying on arbitrary limitations on terms or mandatory retirement age.

### Next Article

This series on “The Case for the “Expertise” Board” will continue with an article on “How the Board Should Determine What Expertise and Competencies are Core.”

Boards should strive to move from a random collection of individuals to a board of “experts” composed of persons each having particular skills or expertise needed for the board to have as a whole, all of the skills and expertise necessary to achieve its future objectives.

The composition of an organization’s board must be built to meet the organization’s strategic goals. The first element of board composition planning is evaluating every seat on the board and recognize that each represents an opportunity to increase the organization’s expertise. The final element is evaluating the skills and expertise of every individual chosen to fill one of those seats and provide each with the information, resources, training and

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support needed to succeed as individual board members and as a collective board. In between these two steps is the strategic planning process of the organization. Planning and structuring the board's composition without a developed strategic plan is akin to planning and structuring your retirement on purchasing weekly lottery tickets—you may get lucky but do you really want to base a key component on the future success of your organization on luck?

As discussed in last month's article titled "Time to Involve the Board in the Strategic Process" the strategic plan involves three components: strategic thinking, strategic planning and strategic execution. The first two of these three components are critical to structuring the organization's board to

have it best equipped to provide the appropriate direction and oversight to the organization in the coming years.

Collecting and analyzing the current status of the industry, competitors and the position of the corporation and taking those strategic thoughts to

develop the priorities, actions and objectives for the core components of the strategic plan also will provide the core components of competencies needed on the board. Some of these strategic thoughts that form the strategic plan, and should ultimately from the structure of the Board, include:

- What are the organization's growth plans?
- Will it expand into new markets?
- Will the organization develop new products, programs and/or services?
- Will it be an acquirer? Or is it a target?
- Will pending/proposed changes in the law/regulatory environment affect the organization?
- Will the competitive landscape force the organization to act?

Always remember—Structure Follows Strategy—the strategic plan of the organization should drive the structure of the board.

A well developed strategic plan will create job descriptions or qualifications of the requisite expertise or skills for future directors and provide for the board to be composed of those individuals with the expertise necessary for the organization to meet its future objectives.

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