

Are Board Members Well Informed?

By David N. Fuller, CFA

Introduction

I believe that one of a company's critical responsibilities is to involve its board of directors in the management decision-making process. The board is, of course, there for a reason. Look around the table at your next board meeting and consider the reasons each person is there. Much has been written about board composition and selection of directors; directors are selected for a variety of reasons, including their experience leading other firms, celebrity or prestige, professional relationships or contacts and specific knowledge in an important field such as law or finance.

For these and other reasons, these directors were selected because they were seen as valuable business advisors. However, the board operates at a significant disadvantage to senior management. Its meetings are relatively infrequent, and its members don't generally have contact with each other or the company on a daily basis. In order for the board to live up to its value-adding potential, a company must work to overcome these disadvantages by providing its directors with the resources necessary to make the best decisions possible. While this information is readily available for extraordinary decisions (such as in a fairness opinion for a significant transaction), there is a relative dearth of information available to directors on more routine, but collectively more value-influencing, decisions.

Typical Practice

The typical company interacts with its board on a periodic but infrequent basis. Oftentimes, the board meets quarterly, with periodic teleconferences to deal with committee responsibilities or extraordinary events. Prior to the meetings, a "board book" is disseminated to prepare directors for the upcoming discussions. Usually the board book contains an agenda listing the items that will be covered during the meeting, and, for each item, select detailed information. For example, a financial package showing the company's financial statements for the recent quarter along with supporting schedules might be provided to coincide with the agenda item relating to management's report to the board on recent performance. Other items may include proposed resolutions relating to such issues as loans and loan documents, senior management appointments, or senior management compensation.

While the information provided in a typical board book is helpful in terms of preparing the board for the discussions that will take place in the meeting, there is typically little information that would allow the directors to do much more than listen and question within the boundaries of the information presented by management. While there is a tremendous amount of information available, directors often don't have the time, resources or inclination to gather, distill and synthesize that information in order to improve the quality of their input.

Management's Assistance

When the board book is prepared, senior management usually reviews it prior to its distribution. When they do so, the information they see is enhanced by their own background and context, which is the result of daily involvement in the operations of the company. The chief officers have a detailed understanding of where the company's market is going and how the

company and each of its competitors are positioned. They know how the company's operating performance compares to other firms and how the company's securities are performing, both relative to competitors and to the overall market. This information and more is gained as a byproduct of daily interaction with customers, suppliers, employees and investors and is necessary to making informed judgments. Given management's familiarity with the issues facing the company, the information they share with directors often presupposes a level of knowledge outside directors may not possess.

Educating Directors

A considerable challenge arises in transferring management's core knowledge to the members of the board. Between meetings, directors have their own dragons to kill and, while they may come across some information on their own, they are less likely to pick up on the news and events affecting the company than management. Moreover, directors are often not well equipped to conduct their own independent research relating to the company and its competitors in order to keep current on the state of the markets and comparative performance.

It is therefore imperative that the company, either through its own actions or by engaging outside services, synthesizes the information that directors require in such a way that they can evaluate alternatives and make decisions with the highest degree of certainty possible.

The information age has made data of all types more accessible than ever. This can be a hindrance, however, as many feel as if they are drowning in a river of irrelevant facts while trying to grab onto the key information that they can use to their competitive advantage. Only by packaging and providing relevant information to the board in an intuitive manner can directors become better equipped as valuable business advisors. As a related benefit, management will

undoubtedly discover new information by having a comprehensive procedure for searching out, sifting through and analyzing the data for the benefit of the board. However, management should be very careful to provide as unbiased presentation of the information as possible to directors to ensure that their own perspectives don't color director interpretation.

Areas of coverage for the intelligence book prepared for the board should include 1) the condition of and outlook for the economy in the company's geographic scope, 2) the condition of and outlook for the industry and the specific markets in which the company operates, 3) the identity of the company's competitors, their market positioning and the related perceived advantages and disadvantages of each, 4) the comparative financial performance of the company and its competitors for which information is available, 5) the comparative performance of the company's securities relative to those issued by competitors, 6) the level and nature of executive compensation in similar firms and identifiable relationships between compensation and corporate performance, 7) the current opinions of analysts and institutional investors regarding the industry, events or trends affecting the company and its competitors, 8) mergers, acquisitions and divestitures in the industry and relevant deal terms, 9) capital structure comparisons between the company and firms of a similar nature and 10) an analysis of the information that can be gleaned from a comparison of the relative values of the company versus its competitors.

Armed with this type of information, directors are better able to evaluate the alternative decisions proposed by company management and can be more proactive in discussions about key management issues such as corporate strategy and investment decisions. Simply speaking, this information unlocks the value potential for which the directors were elected.

Conclusion

Having consulted several boards of directors over the years, I understand the importance of thorough, accurate and timely information. Faced with competing decisions on almost every issue, research and intelligence is vital to gain the insight necessary to make the best decision for shareholders who directors represent. Also, I am all too aware of the scrutiny under which directors' decisions are examined and the personal liability that attaches itself to their positions as directors.

While specific event-driven studies and reports by investment bankers and consultants are often necessary to assess the merits of an extraordinary decision, the information provided is often narrow in scope and fails to provide the framework, or backdrop, against which informed decisions must be made on the myriad of issues addressed at board meetings. Company's must make the context available to directors, both for their benefit and the benefit of shareholders.

David Fuller is the Managing Principal of VALUE Incorporated, a premier firm in the practical application of valuation and economic theory. VALUE Incorporated provides research and intelligence gathering services to companies to fill the needs illuminated and discussed in this article. He can be contacted in the Dallas office at dfuller@valueinc.com The firm can be visited online at www.valueinc.com