Boards and Directors – a Brief History

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Boards in the sense we know today, especially in the for profit space, are a relatively recent development. However, the precursors for the boards of today date back to the earliest of times, when people would gather together and delegate authority to small groups of elders, deacons, tribal leaders, or others to take actions for the collective good. In American history, many of the earliest settlements in Virginia and Massachusetts also laid groundwork for governance, as they were established by private companies who then had to manage their "investments" on the American continent, as communication with home countries was difficult if not virtually impossible. Governance also has developed differently based on the legal system in place; in England and in the UK, for example, the evolution of common law – with courts, one could argue, established to protect the Englishmen from their king. In France, where civil law evolved, the courts were there to enforce the edict of the state. Even to this day, shareholder rights and the roles of boards have evolved differently based on the starting points of history and law, with substantial differences on constituency, the focus the board (or in the case of many German companies, the boards), the mix of "insider" vs. "independent" directors, and the basic models of governance in use.

In the United States, boards have also evolved differently than those in England, in France and in other countries, as a function of many factors, including the American psyche as a country of settlers and immigrants and – perhaps not surprisingly – politics. For much of U.S. history, boards were simply not needed in the for-profit space: wealth was held by families, and governance was similarly tied to families and their patriarchs. However, as the industrial

revolution came to the U.S. and the shift from agriculture to industry began, the industrialists – people like Carnegie, Rockefeller, Vanderbilt, Harriman, Mellon, and others – not only managed and governed, but owned the companies that they led. The industrialist leaders and their families also had a web of intertwined relationships – shared prep schools, colleges, clubs, and summer locations – that allowed them to steer business to each other for their mutual benefit. And, these relationships extended to some of the "boards" in use at that time – "trusts" (such as voting trusts, amalgamated corporations, and holding companies) – where the trustees and boards were part of that network of families helping mutually ensure continued entrenchment of the powerful families of the day.

Yet the U.S. focus on populism – where Americans love the market and entrepreneurs yet hate monopolists – along with a family desire to diversify – began to change the U.S. corporate landscape, and create today's current need for boards, especially for large companies and for companies that wanted to tap into public capital markets. In 1879, J. P. Morgan successfully sold William Henry Vanderbilt's majority stock in the N. Y. Central Railway to the market. In steel, Andrew Carnegie sold his majority block in the Carnegie Steel Corporation in 1901 as U.S. Steel began its corporate existence. Many other examples exist, but in all cases the industrialists believed they could diversify their holdings, use the proceeds to invest in new ventures, and at the same time continue to maintain control through their informal – and family network – influence over their boards of directors.

However, as a result of many factors – the separation of ownership and control continued to evolve in the U.S. Perhaps because of aggressive WWI "war bond" sales, Americans got used to the idea of investing – though their faith investing was shattered for a time during the Great Depression. The response to the depression – blamed in part on highly concentrated corporate control – unleashed a raft of reforms from Washington. The Glass-Steagull Act of 1933

separated (at least for a time and until recently) commercial from investment banking. The Public Utility Company Holding Act of 1935 forbade pyramidal control of utility companies. And, a host of other reforms passed at that time governing banks, insurance companies, mutual funds and pension funds all prevented any of these organizations from taking on any serious governance influence – leaving the governance of America's corporations to professional managers. The Securities Exchange Act of 1934 relegated to management control over who could stand for election to boards, yet at the same time left boards to monitor management. And, though there have been changes since - with Sarbanes-Oxley attempting to ensure greater independence in the American boardroom - there remain legitimate questions on how effective governance can be when not linked with ownership – clearly a challenge for those assuming director roles in American business today.

Today's public company board space does, however, provide many opportunities for directors. As of 2013, there were approximately 55,000 director roles for US publicly listed companies, filled by approximately 48,500 directors. As the average age for directors has continued to rise, now averaging over 63years, it is anticipated over the next decade there will be substantial opportunities for new individuals to serve as public on the directors.

In addition to public, for profit positions, there are a host of opportunities for directorship with private companies that compose the bulk of US business marketplace. In fact, private firms accounted for 86.4% of all US firms with 500 or more employees, meaning that the public company opportunities are substantially less than the opportunities for board service with private companies. However, identifying private company board roles is much more difficult, and private company board compensation tends to be much more constrained than in their public company counterparts. It is estimated however, that there are well in excess of 1.6 million private company board opportunities in the US.

In the not for profit world, somewhat surprisingly, the evolution of a more formal board structure occurred much earlier than in the for-profit model, even though the number of non-profits was small until the relatively recent past. The first American nonprofit board dates back to the initial founding of settlements in North America when the Massachusetts Bay Company, and others existed – principally in education – from the middle of the eighteenth century onward. In 1940 there were only 12,500 secular charitable tax-exempt organizations; today there are over 1.3 million, with an estimated board population of nearly ten million individuals – providing significant opportunity for those interested in board service.

So, if one wants to serve on a board, what are the options?

First, one can serve as a board member for a not-for-profit corporation or LLC. In many cases, being a director of a not-for-profit entails responsibilities not only for effective governance, but to assist and oftentimes contribute directly in the treatment of the charitable giving objectives of the organization. Unlike a for-profit board, a not-for-profit board will be mission-focused, as the organization must spend all the money it raises on accomplishment of its mission, and has no objective or obligation to increase shareholder wealth, as legally a non-profit has no shareholders. It is important to understand, however, non-profit directorship does, in general, carry the same obligations and can incur similar risks to being a director of a for-profit entity. Those obligations and risks are further discussed in the "The Boardroom Today" publication of The Directors' Institute™.

In the for-profit private space, one can serve as a director on a variety of boards. Starting with the least risk prone-the advisory board, we will discuss the merits, opportunities, risks, and rewards of each of these board alternatives:

- As a member of an advisory board, one often has many of the benefits but generally none of the fiduciary or other obligations of a public-company board member, because it's very title- “advisory” - captures the nature of this opportunity. Advisory boards are often formed by smaller, often startup, entities and play a valuable role to the CEO in providing him or her input and experience that would otherwise not be resident in a company of that size. Advisory boards are many times also be used by larger companies for specific projects or initiatives, such as looking at consumer input, specific advice on a new strategic initiative, or for other reasons where an experience or information void exists. Though no fiduciary or true governance responsibility exists within advisory board, for this reason they also tend to be at the lower end of compensation. So, if ones' objective is to earn money for board service, advisory boards will be less helpful. Often, membership and advisory boards for early-stage companies may also happen as a result of angel or private equity investment in that company, though at the private equity stage oftentimes the investors are looking for greater control at the board level than for a board that is advisory in nature only. For advisory boards, often times there are no committees such as audit or compensation, as there is no fiduciary responsibility normally taken on as an advisory board member, and therefore there is no duty to request a review of audited financials - though in some cases such a review may still take place.

- On a complexity and remuneration scale, the next level board opportunity would be a director of a private company, that is, one not listed on a public stock exchange in the United States. As the number of private companies in today's world far outweighs the number of public companies, opportunities for private company directorship may be more substantial though harder to find. As a director of a private company, one still has

fiduciary and real legal responsibility to the shareholders, though the number of shareholders will understandably be much more limited than in the public company environment. Compensation for private company board members tends also to be only a fraction of the compensation packages that are often given to public company directors. Though for private company boards, directors have a fiduciary responsibility, and whether or not the private company has committees such as audit, compensation, or governance will tend to be a function of the size of the company and its complexity. Should one be a director of a private company, however, be aware that the duties of directorship can be held legally against you and you should consider the possibility of maintaining director and officer insurance through the company or personally.

- Finally, there is the director role for public company. Here, one has greater legal risks as litigation against companies in United States can oftentimes name that company, specific executives, and in many cases the Board of Directors as defendants, especially in situations involving significant market capitalization declines. The benefit, however, to being a public company director is in the learning and complexity, as well as in the compensation level one can achieve. Average total compensation for board members of S&P 500 companies has been in the range of $250,000 annually, though it is often a mix of cash, options, and in some cases restricted stock unit compensation. If one achieves or holds the role of the director of a public company, it is imperative that you educate yourself on the legal risks, and ensure that any company-held director and officer insurance provides you personal coverage with which you are comfortable.

Serving on a board can be rewarding - professionally, developmentally, and financially - but getting on a board is often not an easy task, and once on a board one has to be aware of the opportunities and risks of such involvement. These risks, and a further discussion of roles,

opportunities, and challenges of board service may be found in The Directors' Institute™ primer on boards entitled "The Boardroom Today", available for members of the Directors' Institute.