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NAVIGATING THE FIRST YEAR:

A Guide for New Directors

Executive Summary

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DIRECTOR'S HANDBOOK SERIES

Executive Summary

DURING THE 2021 PROXY YEAR, directors from "historically underrepresented groups" by race and/or gender accounted for 72 percent of all new directors, compared with 59 percent last year, reports the 2021 Spencer Stuart Board Index.[1] Nearly half—47 percent—of the 456 new independent director class were from underrepresented racial and ethnic groups. Many (33% of the total) were Black, reflecting the renewed commitment to board diversity in light of what has been called the "racial reckoning" of 2020.[2] At 43 percent of incoming candidates, women (including women of color) were also well represented.[3]

The National Association of Corporate Directors (NACD) has developed this handbook to support individuals assuming their first major directorship or their first directorship on a public company board. Nominating and governance committees can also use it as a reference to benchmark and improve their new-director onboarding processes.

According to NACD's Nominating and Governance Committee Chair Advisory Council—a group of Fortune 500 committee chairs—the onboarding process for a new director begins at the interview stage.[4] Formal and informal onboarding activities that enable a new director to create value by consistently contributing well-informed insights often takes at least a full year. On high-performing boards, that first year of orientation provides a foundation for ongoing learning, as all directors engage in continuously expanding their knowledge and understanding of the business.

By the time you've landed your first board seat—particularly your first public company board seat—you've likely already built credibility and a strong reputation. Upon joining a new board, the question becomes, "How do I demonstrate that the reputation I have is well deserved?" Let your early contributions to the boardroom dialogue be informed, and don't be afraid to let your early contributions be insightful questions.

Rising expectations from shareholders and regulators, a volatile operating environment, and increasingly complex businesses create a steep learning curve for new directors. How can a new director accelerate this learning curve in his or her first year of board service?

About NACD

For more than 40 years, NACD has been helping boards elevate their performance and create long-term value. Our thought leadership continues to raise standards of excellence and advance board effectiveness at thousands of member organizations. Through our insights, education, and credentialing—supported by our peer network of over 23,000 members—boards are able to make high-quality decisions on the most pressing and strategic issues facing their business today. To learn more about NACD, visit nacdonline.org.

1 Spencer Stuart, "*2021 US Spencer Stuart Board Index*" (Spencer Stuart, 2021), p. 4.

2 Jena McGregor, "A Third of Newly Added Corporate Directors Were Black Last Year, Up From 11 Percent," posted on forbes.com, October 19, 2021

3 Spencer Stuart, "*2021 US Spencer Stuart Board Index*" (Spencer Stuart, 2021), p. 4.

4 NACD, *NACD Nominating and Governance Committee Chair Advisory Council: Effective Director Onboarding Practices* (Washington, DC: NACD, 2015), p. 1.

Four Cornerstones of Learning

AS A NEW DIRECTOR, you can benefit from incorporating four learning cornerstones that collectively can accelerate any director's learning curve in the first year of board service:

1. **Understand the environment in which the company operates.** A new director's familiarity with the company's industry and operating environment varies depending on the director's previous professional experience. But it is critical that the new director understand a number of external factors that affect the company and business environment prior to attending his or her first board meeting.
2. **Learn about the company itself.** The new director must acquire knowledge not only about the company's financial performance but also about other aspects of the organization, including its products, its people, its operations, and its reputation with consumers and with society in general. As noted above, on leading boards, every director—regardless of tenure—spends time to continuously refresh his or her knowledge regarding cornerstones 1 and 2.
3. **Familiarize yourself with boardroom practices and dynamics.** Over the past several decades, the role of the board has expanded significantly as the board has assumed new responsibilities and is more proactively engaged in areas such as strategy-setting, throwing aside the old review-and-concur mind-set that used to prevail. Moreover, understanding boardroom dynamics and unwritten rules of engagement among directors and between the board and management can help you increase your impact as a new director. How do directors interact with executives inside and outside the boardroom? How are decisions made? How are disagreements resolved?
4. **Clarify your role and responsibilities as a director.** Expectations surrounding director performance have risen, and the stakes are high. Help inform your learning path by understanding exactly why you were invited to join the board and what role will you play on the board. Liability is a concern for many directors, and the best protection against lawsuits is to uphold your fiduciary duties and apply due diligence in your oversight.

The optimal onboarding experience integrates these four learning cornerstones with materials and experiences provided by the company and the board itself as part of a formal orientation process.

CORNERSTONE 1: Sample Content

Understand the Environment in Which the Company Operates

What regulatory requirements affect the way this company operates? What state laws affect the business?

The weight of federal regulation on companies operating in the United States is significant. Federal laws and regulations affecting corporations abound, with the ratio of laws to regulations averaging about 1:20, extending the reach of each new law.[5] US criminal laws and related regulations alone span more than two dozen areas, ranging from antitrust to tax.[6] From 2016 to 2020, 574 organizations were sentenced under federal criminal laws. The Federal Sentencing Guidelines allow federal judges to hand down lighter sentences to corporations with strong compliance programs, but recent policy changes at the Department of Justice have set the bar higher for leniency.[7] Clearly, corporate directors have an important job in setting the tone at the top when it comes to ethics and compliance.

[5] Clyde Wayne Crews Jr., "The 2021 'Unconstitutionality Index': 19 Federal Rules and Regulations for Every Law Congress Passes," posted on forbes.com on February 2, 2021.

[6] For a chart showing 25 areas where corporations have been sentenced, see Table O-1, Fine and Restitution for Organizational Offenders by Type of Crime, *2020 Annual Report and Sourcebook of Federal Sentencing Statistics* (United States Sentencing Commission, 2020), p. 169.

[7] The Department of Justice announced on October 28, 2021, that to achieve lenience organizations must name individuals. This announcement built on the precedent of the Yates memo, released during the Obama Administration.

The regulatory landscape has grown in complexity, including new and changing requirements and standards at the state, federal, and international (region- as well as country-specific). Directors must consider how proposed rulemaking could affect the company, business practices, and the cost of doing business.

Directors should also be mindful of any industry-specific regulations affecting how the company operates.

Recommended action:

Find out from the general counsel and audit committee chair which major regulations (or regulatory risks) the company must comply with or monitor and how these requirements will affect business processes. Review, if available, the record of the company's most recent regulatory probes and past compliance violations to determine key risk exposures.

Additional guidance:

For more information on board oversight of these matters, please review NACD's Corporate Governance Requirements Resource Center and Compliance and Ethics Oversight. For details of corporation laws by state, visit law information site FindLaw.com's State Guide: Corporation Laws document.

Recommended Reading for New Directors

- Board meeting minutes from the past 12 months
- The company's most recent strategic plan
- Committee reports, especially from the audit and compensation committees
- Charters of any board committee to which you may be assigned
- The board's bylaws
- The company's corporate governance guidelines
- Company press releases from the past 12 months
- Reports from both external and internal audit
- Analyst reports on the industry's outlook
- Analyst reports on the company
- Company annual report and proxy statements from the past few years

CORNERSTONE 2: Sample Content

Learn About the Company Itself

How has this company's strategy evolved over time, and what is our long-term strategy?

Understanding the business means understanding prior iterations of the strategy that have led the company to have the market position it has today. Also understand the drivers of strategic differentiation, along with the company's core competencies and competitive advantages. Does the company strategy strike the right balance between being growth-oriented and being value-oriented (looking for not just bigger size but also sustainable returns)? How well has the strategy been executed against? The strategy should have a strong, clear bent toward creating long-term value, using interim short-term goals as milestones that align with long-term objectives.

Recommended action:

Talk to the lead independent director (or another board leader) or the CEO to discuss the evolution of the company's strategy and how the board has been instrumental in the strategy development process. Ask the CEO how the strategy is created and what the strategic planning process looks like. Then, understand clearly how the strategy, goal setting, and annual operating plan are aligned. Know the long-term strategy well, and know its vulnerabilities and the adjustments that can or should be made if those vulnerabilities are realized. Understand the building blocks of the firm's long-term strategy. In what areas did it place its big bets? What trade-offs did it make? What alternatives did it consider, and what are the metrics the firm is using to assess its attainment of long-term goals?

Additional guidance:

For 10 recommendations on directors' roles in strategy development, review the *Report of the NACD Blue Ribbon Commission on Strategy Development*. For guidance on assessing the level of alignment between a company's short-term activities and its long-term strategy, review the *Report of the NACD Blue Ribbon Commission on the Board and Long-Term Value Creation*. Additional resources can be found in the NACD Strategy Oversight Resource Center.

Questions to Ask During Meetings With Business Executives

Director onboarding meetings commonly include meetings with members of the executive team. As you go on your own listening tour to meet with executives and general managers, here are some questions to help spark conversation:

- Where do you want to take your business line?
- What are your goals for five years from now, and how do you plan to accomplish those?
- How much investment has been made into your business line, and how are you using those resources?
- How would you describe the culture within your department?
- What can you tell me about your leadership style?
- What is your philosophy and do your employees know it?
- Why do people buy from you?
- What are the performance trends in your division? Are they improving, or are they declining? Why?
- What are your biggest challenges to making necessary changes in your division?
- What are you doing to differentiate your products from competitors'?

CORNERSTONE 3: Sample Content

Familiarize Yourself with Boardroom Practices and Dynamics

What is the role of the board versus that of management? How does the board interact with company management? How does your board scope its mandate and its responsibility?

The old adage of "noses in, fingers out" aptly describes the board's role of oversight, as management's role is "fingers in" the daily operations of the company. As directors expand their influence and time commitment, however, they need to stay vigilant about the dividing line between overseeing and managing the business in order to avoid the risk of creating unhealthy friction with the executive team. A positive board–management dynamic can be hindered by:

- ineffective communications, which can play out as a lack of openness in sharing bad news along with the good, or in extremes of overreporting (information overload) or underreporting (lack of sufficient support for key points);
- overstepping boundaries as a board, and trying to run operations;
- being pressured by management in a way that dilutes the strength of the board's oversight role; and
- an addiction to short-termism on the part of either the board or management.[8]

[8] NACD, *Director Dialogue: The Board's Evolving Relationship With the C-Suite* (Washington, DC: NACD, 2016), pp. 3–4.

Recommended action:

Understand existing expectations as to the format, content, and frequency of information provided by management to the board.

Additional guidance:

To learn more about what fosters or hinders good board–management dynamics, please review the NACD brief *Director Dialogue: The Board's Evolving Relationship With the C-Suite*. Additional information can be found in NACD's *Director FAQ: The Role of the Board vs. the Role of Management*, which offers clear guidance on the role of directors as fiduciaries and how the board can maintain its oversight role even in discussions about strategy.

CORNERSTONE 4: Sample content

Clarify Your Role and Responsibilities as a Director

What are my essential functions as a director?

As a director, you will join fellow directors in making decisions on behalf of the corporation, particularly those reserved to the full board alone (and which may not be delegated to a committee or to management), namely:

- amendment of governing documents;
- approval of a plan of merger or consolidation;
- sale, lease, or exchange of all the company's assets; and
- dissolution of the corporation.

Furthermore, as a director or member of a committee, you may be expected to fulfill functions reserved for the board or delegated to a board committee (and which may not be delegated to management), namely:

- declaration of dividends;
- approval of derivative litigation;[9]
- compensation of directors;
- compensation of the CEO (and in some cases, other senior officers);
- election of officers;
- issuance of stock, stock options, or rights and retirement of stock;
- approval of standards for indemnification of officers, directors, employees, and agents; and
- reduction of the corporation's legal capital.

*Adapted from NACD's Customizable Director Role Description.[10]

Recommended action:

Talk to your nominating and governance committee chair about your role and what it looks like to successfully perform your core responsibilities. Being successful and showing leadership skills will certainly mean extending beyond just the essential requirements.

Additional guidance:

Review NACD's *Customizable Director Role Description*, which details the major functions and responsibilities of a new director. A board's written governance principles are the foundation for a board's continuous-improvement efforts. For more information, view the *Report of the NACD Blue Ribbon Commission on the Strategic-Asset Board*.

[9] If a shareholder wants the corporation to file a lawsuit, the board or a board committee must approve this so-called derivative litigation request.

[10] NACD, *Report of the NACD Blue Ribbon Commission on Director Professionalism* (Washington, DC: NACD, 2011), p. 19.

What shouldn't I do in my first few meetings?

Red Flags and Sample Ground Rules for Board Meetings*

Often, boards set standards for their meetings, which serve as guides for new members and offer a framework for handling difficult issues. Examples of one board's ground rules are below. They are not intended to be strict requirements—individual boards will develop their own operating principles—but they can serve as a starting point for discussions between prospective or new directors and board leaders:

- No interruptions except by the chair.
- Do not confront other directors in a threatening manner.
- No side conversations.
- Don't forget to consider the unintended consequences of remarks you make.
- Don't beat around the bush. Speak directly and candidly in a professional manner.
- Don't disrespect. Treat everyone, including management, with respect and consideration.
- Be careful of your assumptions. Fully understand the problem before proposing "fully baked" solutions.
- Realize there are no sacred cows and no stupid questions.
- Don't take probing questions as a challenge or affront.
- Agree to disagree (reduce pressure toward unanimity).
- Don't procrastinate. Take or make time to deal with substantive issues.
- Don't hold back for the sake of harmony. Everyone should contribute.[11]

* Adapted from *NACD's Board Dynamics: How to Get Results From Your Board and Committees.*

Conclusion

JOINING A BOARD MEANS becoming part of an establishment in which a significant amount of trust and confidence are placed. As noted in the *Report of the NACD Blue Ribbon Commission on Director Professionalism*, "Director professionalism begins with directors themselves—independent, qualified individuals who serve the interests of the shareholders they represent through an effective governance process. In determining this process, directors should first recognize the importance of their own autonomy and abilities. They need to explicitly agree that the board has a function independent of management. Directors fulfill this function by offering the best of themselves and by seeking the best in their fellow directors."[12]

Elements of Onboarding Programs

Companies facilitate the new director's learning process in a variety of ways, and a view into those orientation programs is often available through the company's corporate governance guidelines.[13]

Surveying the orientation section of corporate governance guidelines reveals that the process often includes

- meeting with management,
- reviewing briefings on the company's financial statements,
- meeting with legal counsel,
- attending committee meetings as a visitor,
- reviewing a dossier containing essential information about the company,
- attending third-party director education programming,
- visiting company sites (e.g., branches, plants, stores), and
- meeting with the internal auditor.

[11] NACD, *Board Dynamics: How to Get Results From Your Board and Committees* (Washington, DC: NACD, 2012), pp. 24–25.

[12] NACD, *Report of the NACD Blue Ribbon Commission on Director Professionalism* (Washington, DC: NACD, 2011), p. 19.

[13] New York Stock Exchange–listed companies are required to include a description of their director orientation and continuing education programs.