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The Evolving Role Of Lead Directors

By Mitchell Bryan

The evolution and expansion in the role of designated "lead directors" has been a significant change to corporate boards in recent years.

Through the 1980s and 1990s, the modest percentage of boards that created this position typically did so to empower and mobilize one of their independent members, to serve as an ad hoc trouble-shooter in response to a temporary crisis, or as a task force leader in undertaking a daunting board initiative.

In early phases of this trend, for example, lead directors were sometimes appointed for the limited purpose of spearheading a search for a new CEO, or for replacements to fill unexpected board vacancies. Other lead directors were enlisted to tackle special assignments, such as working closely with an outside consultant and reporting to the board to help it navigate the decision-making process on a major prospective corporate transaction that could materially affect the company's future profitability.

As scrutiny of board performance increased in the wake of Enron, WorldCom and other corporate debacles, the importance of a board's ability to counterbalance the necessary day-to- day strength and confidence of the CEO became acutely apparent. The position of lead director has gradually become one of the key mechanisms by which independent board members enhance their efforts to accomplish this difficult aspect of their duties. Today's lead director serves as a full-time facilitator of critical interactions between the CEO and independent directors, a coordinator of independent director activities, and an at large ombudsman for the board as a whole.

Sarbanes-Oxley almost single-handedly mandated improved effectiveness of independent directors in overseeing management and guarding against domination of a public company's board by its CEO. Some commentators believe a stronger catalyst for growth in the lead director's role was the New York Stock Exchange's 2002 requirement that independent directors of its listed companies convene an executive session without management present at least once each year. While NYSE standards encourage appointment of a leader for the mandatory executive session, they provide little guidance in respect to specific responsibilities of the meeting leader. This intuitively compelled independent directors to develop an administrative and functional structure for the meeting that placed a lead director in charge of planning, presiding over and reporting to the CEO the results of the executive session. The full range of a lead director's functions flowed naturally and progressively from this initial assignment.

Whatever may have been the primary driver, the appointment of lead directors has proliferated. Studies by Spencer Stuart Board Index and the Investor Responsibility Research Center report the percentage of Standard and Poor's 500 companies whose boards appointed lead directors surged to 94% in 2004 from 26% in 2002. While such statistics have not been compiled for smaller public companies, privately held companies and nonprofits, a similar trend among them is likely, though at lower percentages.

The need for a lead director is greatest where the CEO is also the board chairman. When the power of both those offices is concentrated in a single person, there is a greater risk that independence will be compromised. A 2004 Blue Ribbon Commission of the National Association of Corporate Directors, showed that a "lead director" is unnecessary at boards whose chairmen are not company executives because the presiding independent director is a sufficient counterbalance to the CEO.. The Commission also points out that the role of a lead director is quite different from that of a non-executive chairman and should be clearly delineated at the outset of a lead director's service. Still, while ordinarily vested with less formal authority than that of a non-executive chairman, a lead director's impact on a board's performance can be comparable to that of a presiding independent director.

What exactly is the full range of a lead director's functions? In broad terms, the lead director must provide leadership complementary to the chairman and CEO so as to manage and facilitate the board's governance process in a manner that ensures board independence from management.

Presiding over and communicating to the CEO the results of executive sessions alone are challenging tasks. While the lead director must have the ability to stimulate robust discussion on the company's key issues and synthesize competing views, he or she must be an equally skillful listener to produce a report to the CEO that crystallizes the collective sentiment of the independent directors without personal bias. As noted by the Hay Group Inc., "Perhaps the lead director's most important function is to serve as an objective conduit through which directors can communicate."

Equally demanding and filled with cross-tensions are a lead director's related duties, which include many of the following:

- Calling and setting agenda for meetings of independent directors
- Maintaining a close and collaborative relationship with the CEO
- Managing annual performance assessments of the CEO as president and chairman
- Reviewing CEO recommendations for appointment of committee chairs and members
- Communicating with committee chairs to ensure effectiveness and adequate resources
- Acting as liaison between the board and shareholders or other company stakeholders
- Developing and mentoring new board members
- Conducting annual board member performance
- Reviewing director conflict of interest issues that may arise

The rigors of serving as a lead director are considerable, and cause some boards to rotate the position among a group of independent directors.

While appointment of a lead director is either unnecessary or unworkable for many public and private companies and nonprofits, the overall impact of lead directors appears to be positive. On the frontier of corporate governance studies, one can anticipate development of metrics for understanding the benefits and perhaps drawbacks of installing a lead director. Until then, as in performing all other director responsibilities, boards must assess the usefulness of a lead director by exercising good faith judgment upon consideration of currently available information.

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