

THE GOVERNANCE REVOLUTION

What Every Board Member Needs to Know, NOW!

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Foreword

It was September of 2015 and I had just read “How the Board Can Be Helpful to the CEO” in the Third Quarter issue of *Directors & Boards*. I was so intrigued with the insights the author, Deborah Midanek, brought to both sides of the equation that I emailed her and suggested we get together for breakfast the next time she was in New York, with no agenda, other than two people interested in board governance getting together, and seeing where the conversation flowed.

Fast forward three years. After a two-night, two-sitting, can't-put-it-down read of Deborah's draft of *The Governance Revolution*, perhaps I came full circle with Deborah's command of board governance after she asked if I would write the Foreword.

The impetus for the “two-sitting, can't-put-it-down” read was an endless series of “ah-ha” moments. I gained a far better understanding of how we've arrived at the current state of the biases and complexities embedded in today's interpretations of the legal and social aspects of governance principles. Who would have thought that our origins date back to 1602 with the Dutch East India Trading Company? I was barely born at the time. “How novel it was to decide how to allocate capital, and be trusted with keeping the capital, rather than returning it at a journey's end. It was organized as a stock company with *participanten*, economic participants but not managers, and *bewindhebbers*, who acted as managing directors, and all were offered limited liability.” The Dutch company raised a huge amount of capital, all without the complexity of Dodd-Frank or Sarbanes-Oxley.

The (r)evolution is the second ah-ha of her masterfully documented, and fact-filled piece. An eloquent chronology of all noteworthy, and frequently painful, twists and turns in the governance journey, ranging from The Boston Manufacturing Company creating the first known private corporation in the US in 1810, to the Sherman Anti-trust Act in 1890, limiting market share of corporations, to the first in-house Investor Relations Department (GE, 1953. . . they surely need it now), to the rise of the importance of outside directors with the bankrupt Penn Central Railroad (1970). A milestone noted by Deborah was the 1976 NYSE new listing requirement to have an audit committee composed of outside directors with access to all financial information.

It is more than worth the time of any experienced or new board member to understand how we got where we are, and as the TV ads say, “our ancestry.” Many more “ah-ha” moments from Deborah. The hostile takeovers of the 1980s, the emergence of private equity as an asset class, unintended consequences of program trading, and the collapse of Enron brought about their own set of stresses and strains, and government regulations. While the journey is never complete, the 2003 requirement that public boards have a majority of independent directors, and that audit, compensation, and nomination committees be composed entirely of independent directors shifted the equilibrium of the board once again.

The Governance Revolution goes on to capture the mutual fund revolution where Vanguard founder Jon Bogle is quoted saying that “salesmanship has superseded trusteeship as the primary focus.” And, importantly, she adds that “unless board members have grown up in the dynamic capital markets, it is difficult to understand the motivations of the various parties that may be knocking on the board room door.” That may be the greatest contribution of this work.

Deborah has quite a credible Wall Street career, starting the interest rate swap (derivatives) function at Drexel Burnham in 1984, to creating Solon Asset Management Corporation, with \$1 billion AUM, building a no load mutual fund complex in record breaking time, to being an accomplished turnaround professional and director of 23 companies and with that many engagements as a turnaround manager, you have to smile at her characterization of the board of a troubled company as “having their head in the sand, or up the river in Egypt. . . also known as denial.” I readily grant her credibility conducting this archeological dig and providing us readers her “forward looking statements” and “ah-ha” moments.

Not lost are Deborah’s own insights about director roles (“not to maximize shareholder value, but to protect and enhance the health and value of the corporation”), to her conviction that directors and boards must understand that the buck stops with the board. . . the board is ultimately in charge. This is perhaps Deborah’s most powerful and lasting directive to all of us. None of us want our careers tainted as with the Federal Reserve actions to Wells Fargo. This is Deborah’s clarion call to all of us sitting, and future, outside directors.

Of all, I most appreciated Deborah’s plain and simple review of The World Economic Forum’s new paradigm for boards, which Deborah, distills “to the simplicity often found on the other side of complexity”. The new paradigm covers strategy, engagement, social responsibility, risk management, partnering with management, and tone at the top. It calls for private sector consensus, lest the unprecedented power of a relatively small number of institutional investors provoke further regulatory reforms. The new paradigm further calls on investors to speak out against the short-term demands of activists.

On a lighter note, but maybe not, Deborah also covers “Yes, Virginia, you did sign up for this.” In signing up, we have accepted responsibility for the welfare of the company, and providing leadership for its sustainable future. Count me in, Deborah, and thank you for giving me a better understanding of my ancestry, and the best forward practices you so eloquently bring to light.

— Michael K. Lorelli,

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