'The functions of a corporate director'

An address before the Harvard Business School Club of Cleveland, May 31, 1949.

BY SIDNEY J. WEINBERG

Editor's Note: Sidney J. Weinberg (1891-1969) was present at the creation of modern-day corporate governance. When he became chairman of Goldman, Sachs & Co. in 1930 (having joined the firm in 1907), he would witness within a few short years the historic legislation that gave birth to the Securities and Exchange Commission and other regulatory initiatives. That 1930s legislation, along with attendant legal rulings of the period, began to define what we would rightly recognize today as the characteristics and workings of an independent board of directors. For anyone who might think that an era of good corporate governance was ushered in with the passage of the Sarbanes-Oxley Act of 2002, be prepared to be astonished. Mr. Weinberg's advice on the proper conduct of board members — as exemplified by his 1949 speech that follows and his 1933 memorandum to company chairmen (see page 24) — are remarkable documents. They attest to an enlightened approach to director participation in the affairs of the corporation that resound strongly and credibly over half a century after the recommendations were first issued. During his lifetime as an investment banker and public servant, Mr. Weinberg held more than 40 corporate directorships, among them Champion Papers Inc. (1954-1964), Cluett, Peabody & Co. (1930-1957), Continental Can Co. (1930-1964), Ford Motor Co. (1956-1969), General Electric Co. (1945-1963), B.F. Goodrich Co. (1930-1962), McKesson & Robbins Inc. (1934-1963), and Sears, Roebuck & Co. (1930-1953). One can only imagine how these company managers and shareholders in particular — and corporate America in general — benefited from his progressive thinking on how best to govern the public corporation.

— *James Kristie*

Mr. Chairman and Gentlemen:

I feel highly honored at being asked to address the Harvard Business School alumni of Cleveland. As a member of the Visiting Committee of the School, I am greatly interested in its alumni. The alumni are the living results of the School's work and, let me say, I find it always a pleasure to meet them. Out of a group such as yours must come the future corporate directors.

I am going to talk tonight on "The Functions of a Corporate Director," as I have had some experience in this activity. I am afraid it is not a subject which can be talked of, as suggested in your notice of this meeting, in salty terms. That is the reason why I have to read this, which I regret, as I am out of character in doing so.

There are many phases of this subject. I could not cover all phases of a director's functions in a speech as it would make the speech too long, so I will speak briefly and at the end will endeavor to answer any questions you may wish to ask. The questions, I hope, will clarify what I may have omitted in the talk.

A century ago, most corporations were local and dominated by one man. Corporate law required a board of directors, but one man generally controlled the board which, as a rule, was composed of subordinates or relatives. As corporations grew in size and scope and in number of stockholders and became public companies, it became evident that it was necessary to have more diversity in the board of directors. Stockholders insisted on representation on the board aside from the active executive management, and outside directors proved of help to the company in bringing fresh points of view. As a

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Sidney J. Weinberg in 1938, attending to McKesson & Robbins Inc. board matters: 'I consider being a director a semi-public service, and directors should look at it in that way or not serve.'

result, in most widely owned public companies today, some of the directors are executives of the corporation; others are elected from the outside. I am an outside director on the boards of several corporations, and in my talk tonight I am speaking primarily about the functions of an outside director.

There seems to be some mystery about being an outside director of a public company. A great many people do not seem to understand just what it entails, what the responsibilities of such a director are, the field in which he operates, and how he functions.

Language of the law

The laws of many states say that it is the responsibility of the board of directors to manage the corporation. As a practical matter, the directors cannot manage a corporation. In the narrow sense of this definition, the law is a relic of the past, when corporations were small and local. Under the law, the director has no power except during a directors' meeting at which a quorum is present. For the rest of the time, he must fulfill his duties to the corporation through the influence he is able to develop by means of the work he has done and is doing for the corporation. His relations with the internal management as to the operations of the corporation are for the most part advisory. The management of the corporation — that is, its day-by-day executive management — must be in the hands of the officers, who are elected by the directors. The officers' powers are derived either from the by-laws or from resolutions of the board. The board of directors is the supreme body of the corporation.

The law imposes upon a director fiduciary obligations and also the duty of giving to the affairs of the corporation that same degree of care and judgment that a man would exercise in connection with his own affairs; but, in addition to that, there are statutory obligations such as imposed by the Securities and Exchange Act whereby a director of a corporation with securities listed on a stock exchange has to report his purchases and sales to the SEC and the stock exchange, and must also surrender to the corporation any profit he makes arising from purchases and sales within a six months' period. A director who habitually does not attend board meetings may well run a serious risk of liability; if he attends and votes on matters that subsequently go wrong, he can urge that he used his best judgment, but a man who stays away does not have that defense. Also, if the figures put out by a corporation turn out to be wrong, the directors may be liable to stockholders who relied on them to their detriment.

The director has obligations to all stockholders. Beyond his legal duties, he must recognize the broad social responsibilities he has to the general public and to the country.

Composition of the board

The effectiveness with which the director can meet these obligations is influenced by many things, among them the composition of the board itself.

I believe that the ideal board should have a majority of its members chosen from outside of the management and a minority from the executive officers group, although I am on many boards that do not have this ratio. I also know there are many large corporations, including the Standard Oil group, which have no outside directors. There are in my opinion, however, many real reasons why it is desirable to have the majority from the outside.

'There are times when a director who is any good must be willing to stand up and be counted.'

In the first place, the outside director, with his experience in other fields, brings perspective and a fresh point of view to the board's deliberations. He stands in a sense as an interpreter between the outside world and the internal operations of the company. His view is the broad extensive view compared with the intensive view which is natural for the operating officers.

As an example, in 1948, the problem arose in a company of which I am a director, as to whether it should raise its prices because of increased costs or whether it should retain its former prices and take it on the nose. Although this was a management problem, the president called a special meeting of the board particularly for the purpose of getting advice on this problem from the outside directors, which he knew would be of a special value to the management because of their experience in the affairs of many other companies in varied fields of business. The decision was not to raise prices.

In the second place, the outside directors in a special sense represent the stockholders. The outside directors must see that the officers operate the company for the benefit of the stockholders, and must review the work of the officers as well as advise them.

Another reason for having only a minority of the board chosen from management is that the board of directors must fix the compensation of the officers, and on that subject the officers themselves, of course, should not vote. In many corporations, when the officers are a majority of the board, the salaries are proposed to the board by a committee of directors excluding officers, so that in effect the minority of the board determines the salaries. If the salary of an officer is challenged at a stockholders' meeting, I believe it is the duty of the salary committee, or a member of it — and not the duty of the officer — to justify the salary.

Boards sometimes have an executive committee which has the power of the board between meetings. The advantage in having executive officers a minority on the board will in part be lost unless they are a minority also on the executive committee.

I believe a board of 12 or 15 members is the ideal size in that it is large enough to provide diverse points of view and yet small enough to act intimately and efficiently.

The composition of the board — aside from the proportions between officers and outside directors — has developed a good deal of controversy in recent years. Recently there has been an organized campaign to elect women to boards — apparently just because they are women. Also there are groups advocating cumulative voting by stockholders to elect directors.

As to electing women to a board, I see no reason why a competent woman should not be elected to a board, as I think it would be desirable to get a woman's point of view, especially in the case of corporations dealing directly with women as customers, particularly now when some companies have more women than men as stockholders. But the important point is to be sure that you get an able board member, whether it is a man or a woman. As to cumulative voting, there are reasons in favor of it and, I believe, at least equally strong reasons against it. This subject should be given objective study by some institution, which could weigh judicially the advantages and disadvantages of cumulative voting and make public a report to help clarify the situation. I am hopeful that such a study will soon be undertaken by the Harvard Business School.

A basis of cooperation

In order for a director to function effectively, the officers must provide certain tools the directors must have to be informed. Sixteen years ago, when I was being elected to a number of directorates, I drew up a memorandum on the duties and responsibilities of directors, setting out in some detail the basis of cooperation between officers and directors of a corporation, and sent it to the head of each company of which I was a director. Not many years afterwards came the historic episode of

McKesson & Robbins, in which company I was and am a director, and in the investigation that followed, when I was a witness, the attorney brought this memorandum forward and asked me why I had not operated as a director of that company in accordance with the standards I had set up in the memorandum. I pointed out to him that Moses had brought down the Ten Commandments from Mount Sinai, that we all believe in them, but that unfortunately few of us live in accordance with all of them. Perhaps you would be interested to know the chief points I made in that memorandum, dated June 21, 1933 — a time when not so much general thought had been given to this subject as has been since. *(Ed. Note: See pages 24-25 for the full memorandum.)* The points, in brief, were these:

1. Boards of directors should hold regular meetings monthly at a fixed time and place.

2. The directors should receive in advance of such meeting an agenda on matters to be brought up for consideration and, after such meeting, a copy of the minutes of that meeting.

3. Corporation's counsel should be present at every meeting, whether or not he is a director.

4. At the first meeting after the annual stockholders' meeting, the board should have presented to it for approval the salaries of all executive officers for the ensuing year.

5. Executive committee minutes should be submitted to the directors in each case at the next subsequent meeting of the board.

6. Directors should receive monthly figures of sales, profits, balance sheet changes, etc.

7. In addition, all directors should receive copies of all reports and statements prepared by the outside auditors.

8. All profit-sharing plans should be approved by the board and by the stockholders.

9. Options to purchase stock should be approved by the board of directors and by the stockholders, and mention thereof should be made in all published balance sheets thereafter unless exercised or terminated.

10. A corporation should make no loan to officers, directors, or stockholders except after approval by the board of directors — and then obviously only if such action is legal.

11. Questions of bonuses and profit sharing should be discussed and approved by the board with only those directors voting who do not share in such bonuses or profit sharing.

In the light of the experience I have had since drawing up these points, I would add another one — that the comptroller be present at all directors' meetings; and that every board have a committee on audit composed entirely of outside directors and, thereby, have direct contact with the independent auditors.

Tools for the director

Many of these proposals have since become standard practice and a number of them have been enacted into law. Here again, all the companies whose boards I am on do not follow all of these commandments in full — but I still believe in these principles as goals toward which I work.

Some of these points involve data that the directors must receive from executive management and others involve what the director should contribute on his own. Although all of these matters are of vital importance to directors, in many of them it is the duty of the executives, as a first step, to bring the material before the directors.

'To be effective, a director must work at his job — and it is a hard job.'

There are other tools which the officers should provide for the director if he is to function effectively. In broad terms, the officers must give the director cooperation all along the line. The director must be informed of what policies and problems are under consideration by the officers, together with the facts and figures necessary for him to form an opinion on the subject. New plans and policies should be presented not as something in effect or about to be put in effect, but as something in contemplation. If the chief executive officer bears in mind that the board is created to consult together rather than to contend with each other, he will go over new proposals with the directors individually beforehand, and in this way he may find that some modification of his original plan may be wisest and can be brought about without the embarrassment to the board which may occur if the modifications had to be made at a board meeting. I remember one instance when a board was presented unexpectedly with a plan for the corporation to enter a new business quite foreign to its usual line of activity. The board turned the plan down, but less blood pressure would have been engendered all around if the officers had brought it up with the various directors individually before the meeting. The directors should never be presented with a surprise at a board meeting.

The director should be given the opportunity to meet and talk with the younger, coming executives who are not on the board. Only in this way can he get the knowledge which is necessary in choosing top executives from within the organization and form a judgment as to the organization underneath the top management. The director should watch especially for younger men who have possibilities for development. I think it is a good idea for a president of a corporation, after the annual stockholders' meeting, to give a dinner for the directors and the top officers and to have at that dinner what might be called the "sub-cabinet" of officers. This gives a boost to the younger men's morale and an opportunity for the members of the board to become better acquainted with the men who, in addition to the top officers, are operating the company from day to day. It is the custom of Mr. Wilson, president of General Electric — a great and very enlightened businessman — to give such a dinner, after each annual meeting, and I believe they are helpful in every way.

The most important function

One of the most important functions of the board of directors — probably its most important function — is selecting the chief officers. The board should get a good operating management and then back it up. It is certainly true that a corporation is just as good as its management.

The board passes on the salaries of the management, and on other forms of compensation management receives. In addition, the board should make decisions on major policies which are out of the ordinary routine of daily business. They should see that policies determined upon are carried out and watch what the results are. They should continuously check on the effectiveness of the executive group.

In my opinion, an outside director has a difficult task. He must be a diplomat in all his relations. He is dealing continuously with personalities, and I suppose I am revealing no secret in saying that in a directors' meeting you are likely to find a prima donna from time to time. By comparison, being an investment banker is easy. I have long said that corporations should reasonably compensate an outside director for the services he renders the corporation as a director, although it is impossible fully to compensate him for the responsibilities he assumes. A conscientious director must work at it — and not only during the directors' meetings. It is fairly common for boards to have standing or special committees (in addition to executive committees) to look into matters on behalf of the board and report, with recommendations for board action. Sometimes the most important and the most time-consuming activities of an outside director consist of his services on these

John Weinberg's legacy to governance

Three years ago John L. Weinberg was instrumental in establishing the Edgar S. Woolard Jr. Chair of Corporate Governance at the University of Delaware's College of Business and Economics. The creation of this teaching position propelled a parallel development — formation of the Center for Corporate Governance within the business college. Since that time, the center, under the direction of Charles M. Elson, has distinguished itself in the governance field with its teaching, research, and conference programming initiatives.

That was only the opening gambit in Weinberg's generosity and commitment to corporate governance: With a gift of $2 million from the John L. and Sue Ann Weinberg Foundation, the university celebrated in May 2003 the naming of the John L. Weinberg Center for Corporate Governance.


UNIVERSITY OF DELAWARE

Master class: John L. Weinberg (center) and his wife Sue Ann (r.) enjoy the company of Edgar S. Woolard Jr. (l.) and classmates attending a session held in the newly named John L. Weinberg Center for Corporate Governance at the University of Delaware.

The Weinberg legacy as investment advisers, corporate directors, and public servants is a long and distinguished one. John's father, Sidney J. Weinberg, worked for Goldman Sachs for 62 years. John's tenure with the firm was 52 years. John joined Goldman Sachs in 1950 and worked for his father in corporate finance. He was made a partner in 1956 and 20 years later was named co-chairman with John Whitehead. Like his father, John Weinberg served on many boards in his career (including some that his father served on, such as Champion International and B.F. Goodrich). John was a director of DuPont Co. from 1986 to 1995, a period of service closely matching Ed Woolard's leadership of DuPont as CEO (1989 to 1995), and he currently serves as a director of Knight-Ridder Inc. and YUM! Brands Inc. as well as a number of not-for-profit organizations.

"We are delighted to honor in this manner an individual whose very name is synonymous with corporate and financial integrity," Charles Elson says. "The naming of the center for John L. Weinberg sends a strong signal of the newfound significance of corporate governance in the commercial world and demonstrates confidence in the University of Delaware's role in the corporate governance arena."

— *James Kristie*

committees. I consider being a director in a widely owned company a semi-public service, and directors should look at it in that way or not serve.

The business of directing

Now, how does a director go about directing? Judges have said, "Directors must direct." This is perfectly true, but it doesn't seem to me to throw much light on the subject, because it isn't words that count, but work and action.

In carrying out his functions, the director must take the long view in decisions and bear in mind the public interest. He must have a social sense and must be continually aware of the human problems involved in decisions of the board. Board decisions affect human beings. For example, a corporation of which I am a director owns several plants. Business dropped to the point where it became necessary to reduce production, and the natural decision was to close the highest-cost plant. That plant, however, was in a small community, chiefly dependent upon the plant's operations, so that it was necessary to consider the effect on the community and to work out our decision in such a human way as to disrupt the community's life as little as possible, as well as to protect the company's interest.

'I am revealing no secret in saying that in a directors' meeting you are likely to find a prima donna from time to time.'

Controversial matters often come before a board and there are times when a director who is any good must be willing to stand up and be counted. The day of the stuffed-shirt director, elected because he is in the Blue Book, has come to an end. It is better if a controversial issue is not sprung on a board unexpectedly. If at a board meeting there is presented some new plan I don't know about, I will say what I think about the plan or ask more time for study. However, if the chief officers of the corporation do not want me to speak my mind, they should not have invited me to be a director. If they insist on a policy of my silence, I will resign and publicly say why. Above all, directors must be independent. The better way, I have found from experience, is, as I have said, for the president to take up controversial questions individually with the directors beforehand, and that is what most able executives do.

Do your homework

I have mentioned that a director must do homework. No active man on many boards can find time during office hours to study and digest the information that he should have before attending a directors' meeting. Some men make a hobby of stamp collecting. My interest is reading reports from corporations, reports on plans in prospect, reports on the results of plans adopted, and figures on operations, which I usually do on weekends, and at nights. If management gives a director the information he should have before decisions are made at directors' meetings, the director must then give conscientious work and take time to prepare for the meeting itself. The directors should spend time also in developing informal contacts with the executives of the company and the other directors. In the case of many of my directorships, I spend as much time on the company's affairs outside meetings as in meetings.

The board meetings themselves usually involve general discussion of the affairs of the company and the adoption of formal decisions. An important function of the board member during a meeting is asking constructive, challenging questions, which will bring out not only the weaknesses but at times the strength of the corporation and of its officers. But he will not know the right questions to ask if he doesn't know the company and hasn't taken the time beforehand to study the matters coming up at the meeting. Experience in being a director on other boards, I find, is very helpful.

The outside director must not get involved in day-to-day management. I do not feel that I am capable of operating a corporation just because I am a director. I have refused to be chairman of the board or of the executive committee several times because I have felt those are management positions. The job of the outside director is to be an advisor to management, but he should not get entangled in the operations.

Re stock ownership

A director establishes his influence in the corporation through his service to the corporation, rather than through stock ownership. It is not, I think, an important question how much stock a director owns, although I own some stock in each of the corporations of which I am a director. There are some able men on boards of directors who, as a matter of principle, won't own any stock in the corporation, but personally I believe it is desirable for a director to own some stock, within his means. His ability to act as a director depends on the man himself, not on his stock ownership. Every director represents all the stockholders.

The question arises from time to time as to the position of an outside director who — himself or his company — in some way is doing business with the corporation. If their dealings are fully disclosed and fair and reasonable, I see no objection to such a relationship. It should be remembered that all directors must pass on the fairness of any contract and on the amount of compensation to be received and that the director involved does not vote on it, and should not be present when it is voted on.

As in all affairs, problems confronting directors and officers of a corporation change. I find that in every decade corporations have new sets of problems. In addition, every company, like every child, is different, and each presents different problems.

As one example of the relations of the board of directors

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to a specific problem, actual labor negotiations must be left to the experts on that subject among the officers, but the board should be kept fully informed and from time to time may give useful counsel on policies and helpful support to the executives.

The effective director

Now, in closing, I would like to summarize a few of the points I have been talking about.

First, I believe the outside directors should be in the majority in a publicly owned corporation and that they can make an important contribution by choosing able top management and supporting that management, and through bringing to the company's policy problems the perspective and broad views which come from experience as a director in other companies. In meeting company problems, the director must always bear in mind the public interest. One must remember that every time a national corporation takes a step which is, or appears to be, against the public interest, it reacts on all corporations and is detrimental to our whole system of private enterprise.

Second, to be effective, a director must work at his job — and it is a hard job. The outside director must give top priority to his schedule of board and committee meetings. (I have 22 regularly scheduled meetings monthly — boards and committees of boards — and make all of them unless out of town.) The director must conscientiously do his homework to prepare himself for board meetings, and outside of board meetings he must be ready to respond, when requested, to the day-by-day calls for counsel and advice from the executives of the companies he serves. He should be careful to keep out of the internal management of the corporation.

Third, I am convinced, from many years of observing boards of directors, that the influence of a director comes from his faithful, competent, and diplomatic performance of his duties and from his abilities and experience — not from his stock ownership.

Fourth, the board can function most effectively only when executives cooperate with the outside directors. The best way to bring about that cooperation is for management to try and meet what I refer to as the Ten Commandments for cooperation between executives and directors.

'Problems confronting directors and officers of a corporation change; I find that in every decade corporations have new sets of problems.'

Many corporations, I know, have had trouble in getting good directors. The way to get and keep such directors is, I believe, to work with them and keep them informed. Through this mutual cooperation, good teamwork will develop, and that is important for the stockholders and for all concerned.

In conclusion, I wish to emphasize that a director of a company must keep a broad outlook, high hopes, and believe in the future of this country. He must keep his feet on the ground but this need not keep him from looking off to the horizon. ■