Building a team of experts

Addressing the crisis du jour by appointing a single-subject expert to the board can be a misguided tactic.

BY DOUG RAYMOND

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The Cybersecurity Disclosure Act of 2015, which recently was introduced in the U.S. Senate, will, if adopted, require public companies to disclose whether any of their directors have expertise in cybersecurity. If board members do not have such experience, the company would be required to describe what cybersecurity steps had been taken. The bill would also require the SEC to identify the qualifications of a cybersecurity expert. While this legislation would not mandate that public companies add cybersecurity experts to their boards, this is apparently the bill's objective.

As even the most casual observer has noticed, cybersecurity and data privacy are indeed critical issues for most businesses and deserve significant attention and resources. Directors certainly have a crucial role to play in evaluating and reviewing the company's response to these and other risks, and ultimately, the board is responsible for how the company is managed. These concerns should be front and center in any risk management assessment made by a board, especially for a business that tracks consumer information. However, risk management is only one of the functions of the board of directors. And addressing the crisis du jour does not always require the appointment of a new director. In general, boards should annually undertake a complete assessment of their strengths and weaknesses and take a hard look at what skills they most need to strengthen their board and corporate governance. For most companies, the starting place is not to look for a subject-matter expert, but instead to focus on building a board with broad and deep experience in the company's specific industries and markets.

For most boards, their most important role is, absent a crisis or significant transitional situations (e.g., a sale of the company or replacement of the CEO), to set and periodically assess the strategic direction of the company. This includes long-term strategic planning based on the opportunities, risks, and threats faced by the company. In doing so, directors necessarily monitor and oversee the success of the company and its management in carrying out the strategy. Recent scholarship bears out the intuition that significant industry experience in the boardroom can enhance long-term value and strategic response. This is because directors with industry expertise typically have a deeper understanding of the risks and opportunities faced by the business. This allows directors to participate more fully in a critical assessment of company strategy and oversight of management by knowing the right questions to ask of management and their advisers and fully understanding the answers. Further, executives and other decision makers may be more likely to accept advice from industry peers, increasing their receptiveness to board input and better facilitating the exchange of information. Regardless, boards with more independent industry expertise are likely to be better able to make knowledgeable judgments about the company's strategic issues than are boards without that experience.

Conversely, a board built around a team of experts, but not necessarily industry expertise, comes with its own risks. A board comprised of specialized directors or single-subject-matter experts can become "balkanized" and fragmented. For some companies, particularly smaller businesses without significant resources to hire expert consultants, directors may be called on to assist with specific tasks that require special expertise. While this is often a practical solution, it can cause confusion as to the proper role of directors. A well-functioning board that lacks certain technical expertise can always call on outside experts and consultants to help them understand even complex risks without needing to put those consultants on the board or having these directors become too involved in the operations of the company, which can affect their perspective on issues that the board needs to face.

On the other hand, if directors lack significant industry experience, boards can become too deferential to the insiders who understand the industry. The importance of industry experience has also been a theme sounded by activist investors. Many companies that lost contested board elections have found that the industry experts proposed by the dissidents in fact have contributed substantially to better governance processes.

The Cybersecurity Disclosure Act highlights the considerable interest that lawmakers and investors have taken in the composition of corporate boards. This proposed legislation points the way down the path of an aggregation of subject-matter experts, potentially at the expense of the broader wisdom gained by decades of experience in the same or a similar industry. Cybersecurity is undoubtedly a serious issue, but in the long term, a board with industry expertise is likely to be better suited to guiding companies and fulfilling the role of a board of directors. ■

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