



Board Battles

Even as conflicts between CEOs and directors erupt, finance chiefs can wield influence on both sides.

Alix Nyberg Stuart, CFO Magazine
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You could have cut the tension with a putty knife. As one shareholder group was squeezing Home Depot Inc.'s board to divest a major unit last winter, other investors tried to chip away at CEO Bob Nardelli's \$38 million pay package. Earlier this year, the shareholder turmoil cost Nardelli his job. But the troubles didn't end. The audit committee's discovery of two decades of backdated stock options led to a \$200 million noncash charge and Securities and Exchange Commission and Department of Justice probes; employee morale sank; customers were unhappy; and the economy got in a few kicks as a bleak housing-market outlook curtailed America's obsession with home renovation. Behind the scenes, CFO Carol Tome was scrambling to tune out the distractions and focus on the core business. She held two to three times her standard number of investor meetings last year and devoted untold hours to gathering information for the backdating investigation. In what she understatedly calls "a year of drama for Home Depot," she watched the general counsel and the human-resources head follow Nardelli out the door. An obvious question loomed: Would Tome be next?

Boards are getting hammered from all sides these days, thanks to a potent combination of Sarbanes-Oxley rules and shareholder activism. More often than not, management receives some of those blows as well. Wealthy, reform-minded investors like Carl Icahn, former SEC chairman Richard Breeden, Nelson Peltz, Ralph Whitworth, and longtime corporate shaker Kirk Kerkorian are at the corporate gates, if not inside them, through board representation.

The companies they have sought to change include some of America's best-known names: Motorola, H.J. Heinz, Blockbuster, Home Depot, Cadbury-Schweppes, Sharper Image, and Applebee's International. In other cases, board warfare has brought new visibility to companies such as Ceridian Corp. and Take-Two Interactive Software Inc. As investors demand to be heard, boards are responding — and CEOs are leaving.

More Vulnerable than the CEO

Caught in the crossfire is the CFO, whose relationship with the board is becoming

ever more complex. Sometimes this new reality works to the CFO's benefit: he or she may emerge as a dependable source of analysis and a capable manager who can provide stability in troubled times. In other cases, the CFO may be sacrificed along with the CEO, or even identified as the primary source of the problem(s). In any event, it's clear that CFOs must now develop deeper ties with their company's board — even though it does not guarantee them immunity.

"Certainly, when things go wrong at a company the CFO is pretty vulnerable, and in fact may be even more vulnerable than the CEO," says Jerome B. York, a longtime associate of Kerkorian's and last year a member of the General Motors board when Kerkorian held 9.9 percent of GM stock. "We all know that in these meltdown situations, like GM in 1992, the CEO and CFO were fired simultaneously. The same thing [was true] at IBM" in 1993. York, who was CFO of IBM from 1993 to 1995, acknowledges that today outside pressures on both boards and managers are stronger than ever before. York is also working with Kerkorian in his current bid to take Chrysler private.

So are CFOs living in fear of their boards? Not in Carol Tome's case. "I've never been concerned for my job," she says, adding, "I think it's destructive to worry about job security." Indeed, as Nardelli exited, Tome took on additional responsibilities, including oversight of acquisitions, strategy, and credit services. During 12 years at the company, she says she has been mentored by long-term board members, "and if they feel I need to do things differently, they tell me," she says. "I love Home Depot; you cut me and I bleed orange."

In fact, amid all the CEO bloodletting, many CFOs have survived unscathed. Ford Motor has retained Donat Leclair as finance chief, a post he has held since 2003, and Gap has kept CFO Byron Pollitt, even though both Leclair's and Pollitt's bosses departed under fire. At Bristol-Myers Squibb, where longtime CEO Peter Dolan was ousted last fall, CFO Andrew Bonfield is now under consideration for the top spot. When former CFO Douglas Neve left Ceridian in March, the investor group that had launched a proxy battle actually issued a press release chiding the board for letting him go, suggesting that he was the only Ceridian executive they could trust.

Amicable Relations

A *CFO* magazine survey supports this anecdotal evidence of amicable relations between directors and finance executives. While certain issues, such as meeting growth and profitability targets, create tension between the two camps, 65 percent of those responding to the survey say their boards strike the right balance between micromanagement and benign neglect, and nearly 70 percent praise directors' performance in general (see "Board Buddies" at the end of this article). "The board definitely adds value to our financial reporting; there's no question about it," says Arnie Hanish, chief accounting officer for Eli Lilly and Co. and primary liaison between CFO Derica Rice and the audit committee. Lilly's

board now gets involved in specific areas like restructuring assets and the timing of various charges, he says.

Why do the ties between boards and CFOs seem so tight? For one thing, CFOs may be harder to replace than CEOs. "Sometimes the CFO knows more details and is more involved in processes, so you worry more about firing them," says Robert Mittelstaedt, dean of Arizona State University's business school and a member of the boards of public companies IS&S Inc. and Laboratory Corp. of America. Further, adds Crist Associates principal Scott Simmons, "it's easier to find a board member to act as interim CEO than interim CFO, since the CFO skill-set is a lot more specialized than the CEO's." Crist research shows that in the *Fortune* 500, less than a third of audit-committee chairs had previous CFO experience, while 57 percent had been CEOs.

Finance chiefs also may derive some job security as boards shift more focus to the big picture rather than the accounting detail that has traditionally been the CFO's purview. In *CFO's* survey, the topics that respondents ranked as top board priorities were meeting growth/profitability targets and setting future strategic direction. Sarbox compliance and stock-options backdating fell somewhere between the middle and the bottom of the list.

The primary board responsibility for most finance executives remains keeping the audit committee up to speed on accounting policies and other issues that could affect financial statements. But the relationship has become considerably more intense at some companies. Eli Lilly CAO Hanish says that the average length of the audit-committee meeting has doubled and that when the board talks to a finance representative, there is now an "expectation that we'll do a deeper dive than we might have done before." With former Deloitte & Touche CEO J. Michael Cook heading the Lilly audit committee, adds Hanish, "you have to be much better prepared for more technical questions."

Directors Who Direct

Some CFOs consider audit-committee education a part of their jobs. Carol Tome, for example, recently reviewed the accounting rules for discontinued operations in a March meeting with her audit committee, reflecting the company's review of the possible sale of its HD Supply division.

Finance chiefs are also taking a larger role in apprising the board of risk management across the company. In a survey by The Conference Board, around 70 percent of companies said their CFO was the executive primarily responsible for explaining financial and nonfinancial risk issues. "The auditors are always talking to you about financial risk, but they don't do a great job of understanding operational risk," says Arizona State's Mittelstaedt. "That's not the CFO's primary job either," he says, but "I would certainly want the CFO to be analytical enough to think about what-if scenarios beyond finance."

Small, venture-backed companies and their CFOs often benefit from experienced board members taking an active role in operational issues. Akamai Technologies Inc., which went public in 1999, has an ad hoc board committee help analyze potential acquisitions, studying details from bidding strategies to postmerger integration, says J.D. Sherman, CFO of the Cambridge, Massachusetts-based Web-traffic optimization firm. Audit-committee chair Fred Salerno, a former Verizon CFO, stays involved in such matters because, says Sherman, "he understands the capital markets better than anyone else in the company."

But hands-on boards can also pose challenges for CFOs, as evidenced by the recent tendency to form special committees dealing with specific issues. After Jerry York quit GM's board last October, alleging a lack of director independence (the board didn't do its own analysis of a CFO-prepared report recommending against a proposed alliance with Renault and Nissan), the company changed its bylaws. The change allows the board to form administrative committees to independently investigate such issues as the proposed Renault/Nissan alliance. York had supported the alliance, but the company rejected it.

After stock-options-backdating problems were identified last year at Waterloo, Ontario-based Blackberry maker Research In Motion Ltd., the board decided to establish a new oversight committee made up entirely of independent directors with a mandate that included "providing oversight into areas typically under the responsibility of management." Those areas include "a general review of activities within the accounting and finance groups," until at least 2009.

Don't Be a Patsy

There is always a danger that directors will become too involved in day-to-day operations, hamstringing management in order to placate shareholders or regulators. "With Sarbanes-Oxley, the board became enormously more engaged in operations than they ever had been before," says one former finance executive of an East Coast financial-services firm. "The differentiation between management and oversight got blurred." That created mistrust and frustration on both sides, he adds. While most executives surveyed by *CFO* felt their boards struck a fair balance, 7 percent said their boards were too involved.

Directors themselves often struggle with this balance. "You walk a fine line," says Frank Borelli, former CFO of Marsh & McLennan and now a board member at Interpublic Corp., as well as audit-committee chair at Express Scripts and Genworth Financial. He asks finance chiefs every quarter if they stretched in any way to make the numbers. They always say no, which makes Borelli slightly suspicious. He welcomes frequent phone calls from them, he adds, "but I don't want them coming to me too often, so that the CEO feels that the audit committee is taking over." (During his 12-year tenure at Interpublic, Borelli oversaw the departure of two CEOs and four CFOs, often after the loud

expression of shareholder dissent about executive performance and divestiture strategies.)

"We recognize that value is not built through great governance," says Phil Livingston, former CFO of several companies, including World Wrestling Entertainment. He is now a board member for four private and public companies, including Toronto-based beverage producer and distributor Cott Corp., where the board withheld 2005 bonuses from the CFO and CEO, and recently appointed its second finance chief in two years. "We still spend most of our time in board meetings talking about things like customers, sales plans, profitability, and cash flow," he says.

So how can CFOs give their boards what they want without seeming like patsies? Borelli suggests stating their opinions about where the business is headed, giving directors "a second stand-alone view" next to the CEO's. It is critical for the finance chief to support any assessments with such information as cash-flow and working-capital analyses and competitive comparisons, says York. "The board financial-reporting package needs to display the right information and the right analysis, so it's easy for someone working part-time on the company to grasp [that information] quickly."

More than anything, as CFOs take a broader board role, they must build trust through relationships, something nearly 40 percent of *CFO* survey respondents report doing. "You just can't accomplish anything these days without close relationships with every board member," says Eric Rehmann, co-leader of the financial-officers practice at Korn Ferry International. "It's not just the audit-committee chair or comp-committee chair anymore."

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