# Having trouble recruiting directors? Don't despair.

*To improve your chances of getting top-notch directors, you may want to consider some of the following suggestions, related chiefly to streamlining your board and making the board process more efficient.* **BY DENNIS C. CAREY**

If it seems increasingly difficult to recruit good directors it is not your imagination and you are not alone. More important, however, there are steps you can take to make it easier and to ensure that your company has the best shot at recruiting the best candidates for your board. These are but a couple of the conclusions we have drawn from dozens of interviews and informal conversations we have recently had with CEOs as well as a look at the specs of more than 50 director searches we have completed for Fortune 500 companies within the past year. (Spencer Stuart conducts approximately 300 director searches per year; this analysis was conducted on a subset of those searches.)

Much of the difficulty in recruiting directors might be attributed to the basic laws of supply and demand. Demand for directors — as quantified by the increase in the number of our board assignments — is clearly way up. The supply of director prospects, however, particularly of the traditional CEO candidate, is way down.

A number of concomitant trends have caused the demand side of the equation to escalate steeply in recent years. The overall aging of boards is clearly one trend. In fact, a number of our board clients have had to replace more than one retiring director during the same time period, which only adds to the recruiting urgency. Moreover, the emergence of thousands of new companies, as a result of IPOs, spinouts, and related phenomena, has made competition for talent more intense than ever.

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The now well-established "best practice" for boards to eliminate insiders on boards and replace them with independent outsiders — long advocated by governance experts — adds significantly to the drain on the pool of available candidates. Interestingly, even as boards have decreased in size, the demand for independent directors has remained stronger than ever. And, as boards increasingly evaluate their effectiveness and survey the expertise they have on board, they are likely to find themselves deficient in one or more areas of strategic importance. This determination, too, often leads to the desire to recruit new directors.

## Supply constraints

We see several factors constraining the supply side and thus the ability of companies to fill board seats. One of the most significant barriers to recruiting capable directors is related to the fact

# Director Compensation Trends

Spencer Stuart surveys board trends and practices at 100 leading U.S. company boards each year for an annual report called the Spencer Stuart Board Index (SSBI). The firm also compares its results from this leading-company sample with the board structure, process, and compensation practices of the S&P 500 universe of companies. Following are some highlights of the 1998 SSBI report covering the latest findings on director compensation data and trends.

### Average Retainer Inches Up

The average annual retainer for SSBI boards ($40,836) in 1998 rose only slightly over the previous year ($39,695), but jumped a substantial 39% over five years ago. The average retainer for S&P 500 companies is significantly lower at $31,873, most likely because larger companies that tend to pay higher retainers are over-represented in the SSBI.

The distribution of the retainer, as well as the actual average, has changed, too. While more than one-fifth of 1993 SSBI companies paid retainers in the $20,000 to $24,000 range, currently only a scant 4% of companies do. And while only 7% of 1993 SSBI companies were represented in the highest category — $50,000 and up — more than one-quarter of 1998 SSBI companies now are.

**Those having the highest board retainers** *(none has a board meeting attendance fee):*

- Travelers Group: $100,000 (all in stock)
- Monsanto: $90,000 (partially in stock)
- Sears Roebuck & Co.: $90,000 (partially in stock)
- Alcoa: $85,000

**Those with the lowest board retainers:**

- Biomet: $8,000
- Microsoft: $8,000
- Progressive: $8,000
- Republic New York: $6,000

**Average Annual Retainer**

| 1998 S&P 500 | 1998 SSBI | 1993 SSBI |
|---|---|---|
| $31,873 | $40,836 | $29,400 |

**Distribution Of Retainer ($000)**

| | 1998 S&P 500 | 1998 SSBI | 1993 SSBI |
|---|---|---|---|
| Under $20 | 9% | 1% | 7% |
| $20–$24 | 17% | 4% | 22% |
| $25–$29 | 21% | 13% | 26% |
| $30–$34 | 18% | 16% | 18% |
| $35–$39 | 10% | 20% | 12% |
| $40–$49 | 12% | 18% | 8% |
| $50 & up | 13% | 28% | 7% |

### All Stock Retainers Catching On

A revolutionary idea only a few short years ago — a "non-factor" in our 1993 SSBI — all-stock retainers have now become institutionalized at 25 companies, representing 5% of the S&P 500 (the same percentage as last year). A small but significant number of companies are putting in practice what has become widely recognized among governance experts as an effective way of aligning directors' interests with those of shareholders.

The S&P 500 companies that paid all-stock retainers were: Apple Computer, Ashland, Baxter International, Campbell Soup, Chrysler, Colgate-Palmolive, Computer Associates, Cyprus Amax Minerals, Dover, Entergy, Frontier, Grainger, Guidant, Hartford Financial Services, Helmerick & Payne, ITT Corp., ITT Industries, J.H. Harland, Manor Care, Rite Aid, Shared Medical Systems, Times Mirror, Travelers Group (pre-Citicorp merger), Tribune, and Unicom.

### Committee Meeting Fees Being Phased Out?

A look at the five-year trend in committee meeting fees demonstrates a slow but steady decline. Some 83% of SSBI companies paid them in 1993, a percentage that dropped to 71% in 1997 and further to 66% this year.

There is a dramatic range in fees among those companies that pay them, from a low of $250 at Dillard's Department Stores to a high of $7,000 at American Stores. The median committee meeting fee remains virtually unchanged over the past five years, hovering at about $1,000, and 11% of S&P 500 boards pay a higher meeting attendance fee to the chairman than other members.

### Committee Retainers Dwindling As Well

At a shrinking number of companies, directors are paid an individual retainer for serving on a committee: in 1993 about one-third of SSBI companies paid them, falling to just over one-quarter in 1998, and only about one-fifth of S&P 500 companies. The chairman still receives an individual committee retainer at 79% of SSBI companies (down slightly since 1993) and at only 62% of S&P 500 companies. At a small number of companies, retainers for both committee members and chairman may vary by committee.

### Stock Increasingly Defines Director Compensation

In simpler times, only a few years ago, it was an easy task to come up with a figure we called "Total Director Compensation," which we arrived at by tallying the annual retainer, board and committee meeting fees/retainers, and the cash equivalent to any stock compensation. Because of the growing emphasis on the stock component of directors' compensation and its fluctuating nature, it is no longer practical to pin compensation down to one definitive number, but more meaningful to present finite elements on the one hand and the range of stock-based elements offered on the other.

The accompanying table lists stock ownership plans with percentages of companies that subscribe to each. Of particular note is the explosion in the number of companies offering stock options to directors as part of their compensation package.

**Stock Ownership Plans**

| | 1998 S&P 500 | 1998 SSBI | 1993 SSBI |
|---|---|---|---|
| Stock Options | 53% | 42% | 10% |
| Stock Granted in Addition to Retainer | 38% | 47% | 31% |
| Choice to Receive Retainer in Cash or Stock/Stock Units, or a Combination | 15% | 21% | – |
| Stock Granted as Part of Retainer | 23% | 37% | 17% |
| Retainer Paid Fully in Stock | 5% | 3% | – |

that, despite the greater diversity of functions represented on boards, the strongly preferred candidate is still the active CEO or designated heir, preferably one that has been publicly announced. CEOs cite time demands, board date conflicts, and perceived business conflicts as the three primary reasons for declining a board opportunity they would otherwise find attractive. In addition, CEOs are under growing pressure, from their own boards and governance advocates, to strictly limit their service on outside boards.

A few companies, General Electric for example, do not permit any senior operating executives to serve on any outside boards. Others, like Johnson & Johnson, limit service to only one in addition to their own, and many more companies to no more than two or three. Retired CEOs who are more readily available to serve on boards are sometimes almost immediately viewed as obsolete, and newer CEOs, who might theoretically be available, are often under intense pressure to devote their energies to tasks closer to home.

Diversity candidates — including women, African Americans, Asians, Hispanics, and others who are foreign born — with significant profit-and-loss experience continue to be in great demand. These candidates remain a scarce commodity though; the most desirable are often already committed to boards, while others lack the board and business experience our clients demand.

Relative to high-demand CEO and diversity candidates, there is little demand for other professionals who may be available to fill the gap, including, academicians, lawyers, financial service providers, not-for-profit executives, venture capitalists, and staff executives. And the already apparent disparity between the demand for directors and the available supply is further exacerbated by additional factors, including logistics related to the dates, location, and number of board meetings.

## Efficiency tactics

Before you throw up your hands in despair over the difficulty of recruiting top-notch directors for your board, you may want to consider some of the following suggestions, related chiefly to streamlining your board and attempting to make the board process more efficient:

• *Cut Down on the Number of Board Meetings:* A maximum of six meetings a year should generally be sufficient, particularly if videoconferencing and teleconferencing are effectively utilized.

***The emergence of thousands of new companies, as a result of IPOs, spinouts, and related phenomena, has made competition for talent more intense than ever.***

• *Clearly Delineate Board Responsibilities and Limit to a Few Key Areas:* Directors should focus on fundamental areas of responsibility: overall business strategy and general management, CEO succession, evaluating the performance and determining the pay of the top-executive team, oversight of financials and investments, and recruitment and evaluation of directors.

• *Limit Board Size for Maximum Efficiency:* The boards of leading companies have an average of no more than nine outsiders and no more than two insiders.

• *Cut Down on the Number of Committees:* While companies are only required to have audit and compensation committees, we recommend that a committee on directors also be one of the core committees. We caution against having an executive committee that may create a two-tiered board environment.

• *Conduct One Strategy Retreat Per Year:* Such meetings should focus exclusively on business strategy and linkage to succession planning, mergers and acquisitions, and competitive issues.

• *Make Meetings More Convenient:* By conducting meetings in convenient metropolitan areas and adhering to tight time frames, companies can ensure easy access for all directors.

## Equity opportunity

Two additional suggestions are not related to board structure and process but may prove to be important elements in a strategy to attract directors. First, we believe that directors are still underpaid and that they should be offered significant equity opportunity if they sign on. Though it is clear that the primary motivation to serve on boards is not generally financial gain, revamping director compensation in this way may make it easier to attract directors in a tight market. Finally, many companies that lack a presence in the marketplace find that attracting a director with a marquee name can serve as a magnet to attract other desirable directors.

While recruiting excellent directors is perhaps more of a challenge than it has ever been, it is not an impossible task. Particularly given the inequities of supply and demand that currently exist, however, those companies that stand the best chance of success are those that streamline their board process, where possible, and ensure that any hard-and-fast selection criteria for directors are truly essential to service on their board.