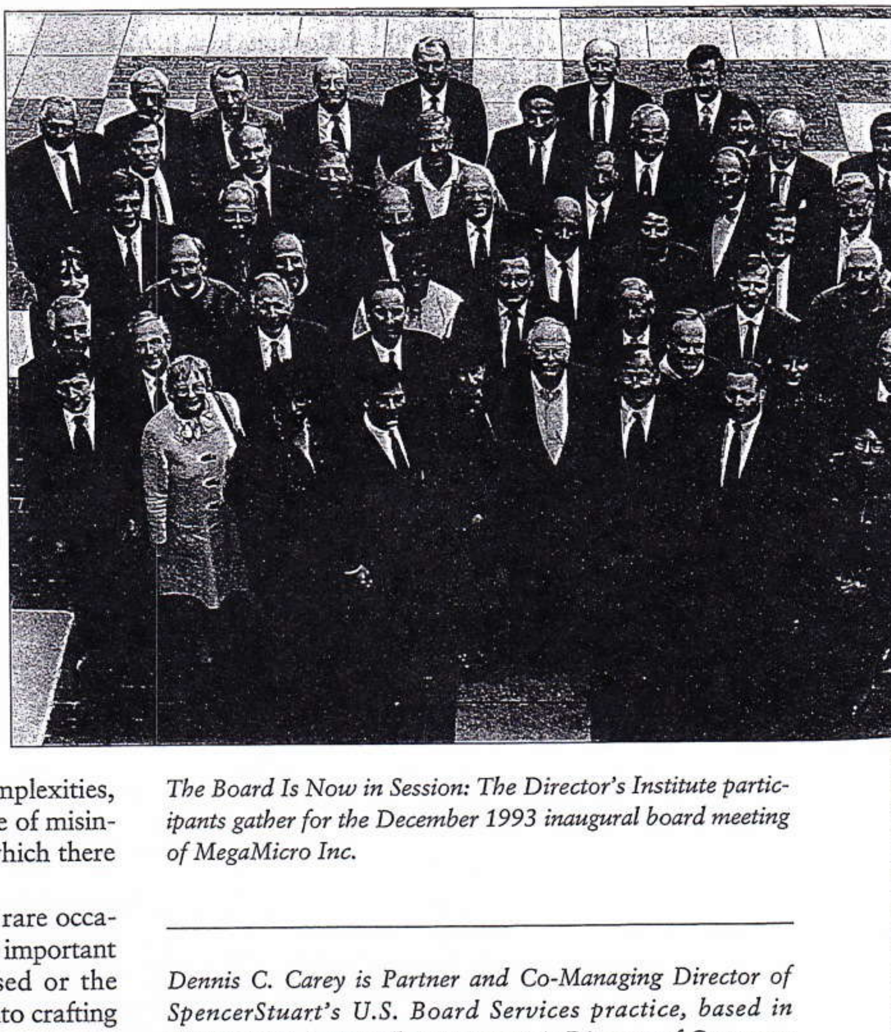
The Director's Institute Is Launched

The Wharton School and SpencerStuart have developed an innovative corporate governance learning experience.

by Dennis C. Carey and Jane Hiller Carpenter

"The day of the corporate director who merely attends meetings and votes is going fast. The complexity of corporate problems has soared, the need for quick response is through the roof, demands on directors are escalating, accountability is increasingly inescapable, market analysts are relentless and unforgiving, and the marketplace has little tolerance for error or incompetence."



The Board Is Now in Session: The Director's Institute participants gather for the December 1993 inaugural board meeting of MegaMicro Inc.

This lament quite accurately reflects the pressures many directors are feeling today. While bylaw definitions of directors' responsibilities may not have changed substantially, the very real challenges directors face in corporate governance have. It was this situation, reported by many directors, that prompted the Wharton School and Spencer Stuart to develop The Director's Institute.

In discussing how an institute might be crafted to explore issues of corporate governance, three things very quickly became clear to the Wharton/SpencerStuart team:

• First, generic or textbook answers, which can be "taught," will rarely address the complexities, ambiguities, lack of information, and presence of misinformation that surround real life issues for which there are often no "right" answers.

• Second, finding "correct" answers (on the rare occasions when they are available) is not nearly as important as the manner in which issues are addressed or the dynamics of dialogue and argument that go into crafting solutions.

• Third, normal models of instruction, which depend on teachers imparting wisdom to students, simply have no relevance to the uncertainties of corporate decisionmaking when the stakes are high.

Based on these perceptions, Wharton and Spencer Stuart have crafted a new and dynamic approach to

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Trying Her New Hat On for Size: Merck CFO Judy Lewent (front left) wore the hat of CFO for MegaMicro Inc. at the Director's Institute; looking on with approval is Robert Kidder (front right), CEO of Duracell and MegaMicro's CEO.

exploring corporate decisionmaking at the board level. It is an approach where no one teaches and everyone teaches. It is an approach that brings into play personal interfaces and confrontations, in a setting where controversial decisions are hammered out by sometimes divided and contentious board members. In short, it is an exercise in real life, boardroom style.

The vehicle for this approach is MegaMicro Inc. (MMI), an imaginary but very real corporate enterprise beset by problems that would test any director's mettle (see sidebar). The Director's Institute provides the "theater" in which participants hammer out solutions to MegaMicro's problems with all the dynamics they would face if MegaMicro were real and they were charged with its governance.

To do this, a team of Wharton faculty and outside experts was assembled from across the United States, and an advisory board was created, to design MMI and determine what problems it would face. Together, they created a company facing issues common to other corporations today, including:

— Restructuring a company and creating a new vision;
— Management succession;
— Board composition;
— Evaluating the compensation of top officers;
— Evaluating the performance of top officers and the board;
— Dealing with institutional investors;
— Dealing with product liability challenges; and
— Dealing with decline in a core business unit.

The Director's Institute participants became the board for MegaMicro Inc. Wharton and SpencerStuart then selected a management team for MMI and chairs for board committees from among advisory board members and other corporate executives. Working in concert with these executives and with faculty and outside experts, the Director's Institute design team identified the issues that each committee would have to address and those that the full board would encounter. The program design called for meetings of the audit, compensation, and nominating committees and then a meeting of the full board.

In preparation for the committee meetings and the board meeting, materials were created to support each agenda. In addition, extensive background information was generated to delineate MMI's history, its current financial situation, and its past performance. The idea was that if the data were complete enough, MMI's "experience" would stand on its own merits. Participating board members would then not have to pretend or play roles. They could simply attend the meetings, be

What Is MegaMicro?

MegaMicro Inc. (MMI) is a $1.8 billion global manufacturing and service company. Founded in 1897, MMI has grown from a medium-sized manufacturer of high-quality industrial chemicals to a diversified supplier of products and services. It has four divisions: (1) injection molding and specialty chemicals, (2) small and large engines, (3) computerized process control systems, and (4) engine and control maintenance and environmental planning and disposal.

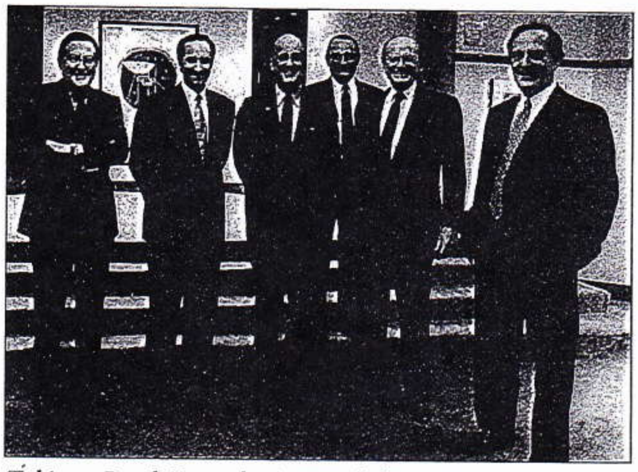
MMI has a long history as a quality producer. It diversified through acquisition and by incorporating internal leading-edge technology into new divisions. However, its long history of success has recently been challenged by foreign competition and recent erosion in manufacturing prowess, both of which pose threats to the Chemicals and Molding Division.

MMI's new CEO has submitted a restructuring plan for the board's consideration. It includes the sale of a major division, taking a significant write-off, "right-sizing" the board and changing its composition, and revamping the compensation system for top officers of the company.

In short, while MegaMicro is an imaginary company developed for the Wharton/SpencerStuart Director's Institute, it is a very real vehicle for enriching the experience and knowledge of corporate governance of the participants.

themselves, and react to the data. This was a critical piece of the Director's Institute design, and it worked.

The first meeting of the MMI board was held in December 1993. The directors in attendance each served on at least one committee or participated in the meeting of the full board. Each director had received an MMI board book before arriving at the meeting. The board book contained the agenda for each committee meeting and for the board meeting, with supporting documentation for each. In addition, each participating director received the company's summary annual report for 1992 and a recent analyst's report.



Taking a Break From the Action: (left to right) Allan Stewart, SpencerStuart, London; Dennis Carey, SpencerStuart, Philadelphia; Frank Cahouet, Mellon Bank Corp.; Robert Beck, Prudential Insurance Co.; Donald Peterson, Ford Motor Co.; and George Helmer, SpencerStuart, New York.

The committee and board meetings were all held in an amphitheater at Wharton Executive Education's Steinberg Conference Center. Front and center in the amphitheater was the board table. As each committee convened, the remaining directors in attendance filled the "gallery" and observed the committee in action. At the end of each meeting, all the directors engaged in a discussion of the issues, exploring the committee's effectiveness in accomplishing its task and the experiences that they had had with these issues at other companies. They then discussed alternative processes, considerations and/or solutions.

The meeting of MMI's full board, with 16 people, was structured in the same fashion. Bob Kidder (Chairman and CEO of Duracell International Inc.), presided as MMI's CEO and chairman. Committee chairs gave their reports. Then the full board addressed the remaining issues on its agenda. Many of these issues related to strategy, and, in fact, the December 1993 board meeting proved to be a pivotal point for MMI.

Mr. Kidder was new to the position, having "arrived" at MMI only eight months before the December board meeting. He took the helm of a company experiencing serious threats to its core business. Margins were shrinking. MMI was no longer the technology leader, nor was it the low-cost producer. Shortly after arriving, he faced significant product liability and quality problems in the second-largest division, the engines division. The MMI board had serious issues to face. They were in the mood for decisions, and they wanted results. And Mr. Kidder had been with MMI long enough to realize that big changes were going to have to be made.

The audit committee, chaired by Frank Cahouet

The Next Meeting Of The Director's Institute

The Wharton/SpencerStuart Director's Institute is an intensive two-day program that simulates, at an accelerated pace, the issues and events a typical corporate board member will face. Each participant is a director on the board of MegaMicro Inc., a fictitious multinational manufacturing and service corporation. Participants meet in key board committees and attend a meeting of the full board. They interact with the MegaMicro management team (executives from other companies), with senior board members, and with outside experts such as KPMG Peat Marwick, Towers Perrin, and Bankers Trust.

Each program addresses the critical issues for MegaMicro, issues such as the board's role in strategy, succession, environmental liabilities, officer compensation, and divestitures and acquisitions. Corporate governance policy issues, such as board performance review, board terms, and composition/diversity of the board, are also addressed.

The next meetings of the Director's Institute have been set for June 22-24 and December 7-9, 1994.

Candidates selected for the Director's Institute provide an interesting and well-balanced mix of industries and experience. *Application to the Director's Institute is by nomination. For further information, contact Jane Hiller Carpenter at (215) 573-3805 or Lisa Mendel at (215) 898-2594.*

(chairman and CEO of Mellon Bank Corp.), grappled with the adequacy and impact of a $50 million set aside to cover quality problems in MMI's engines division. Mr. Kidder was unable to attend this meeting because he was visiting one of the engines division's key customers. MMI's CFO, Judy Lewent (CFO of Merck & Co.), was present at the committee meeting. She was besieged with questions from committee members who felt less than confident that management fully understood the scope of the problem.

The compensation committee had an agenda that was also deeply affected by the woes of the engines division. The committee chair, Bob Beck (chairman emeritus of Prudential Insurance Co. of America), had received a letter from management requesting that the $50 million set aside be exempted from earnings calculations for bonus purposes, arguing that to punish all management for the failure of the division was an unnecessary disincentive. In addition, management was requesting that the stock options, currently under water, be reissued.

Management argued eloquently for its objectives. MMI's vice president of human resources, Hal Burlingame (senior vice president-human resources of AT&T), supported Mr. Kidder in convincing the board that management's renewal strategy for MMI would not succeed with demoralized employees. The committee voted to exempt the special charge from the bonus calculations. The committee did not agree to reissue the stock options, however. Rather, they asked Mr. Burlingame to come back with a form of option grant

The Director's Institute Advisory Board

This is the advisory board of experts that has been assembled to act as an additional resource and to guide the design of the Director's Institute program. As in the December launch of the Director's Institute, they will, in some cases, participate in the program itself as well as give the program administrators added focus and general advice.

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