Specialist Directors

Discussion by Fabrizio Ferri

(University of Miami)

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Specialist Directors (by Nili and Shapira)

Monitoring vs advising/resource provision role

- Brief history: from expertise to independence to accountability…back to expertise (did anyone say Lehman?)
- Rise of ESG also brought expertise back to center stage
  - Climate, DEI, cyber, etc.
- This study examines the trend toward specialist directors, its promises and perils, and its implications
- Mix of data, interviews, qualitative insights, multidisciplinary
- Paper examines a **timely** and **important topic!**
    - Spencer Stuart Survey: "Well-rounded Directors favored over issue expertise"
    - I am working on it…must be important!

My comments

1. Specialist Directors or Directors with Special Skills?

2. What is unique about these new “ESG” skills?

3. Policy implications: standardizing disclosures?

4. Where does the pressure to add this new expertise come from?

1. "Specialist Directors or "Special Skills"?

How much is this trend about

"specialist directors" vs.

"generalist directors with special skills"?

1. “Specialist Directors” or “Special Skills”? (cont’d)

- 2022: 723 directors with cyber “skill” in the matrix
- **570 directors** are newly added cases (relative to 2019)
  - **348 cases (61%):** 2019 matrix did not have “cyber” skill
    - Authors: change in reporting/disclosure
    - My take: *existing directors* already had cyber skill (or they recently acquired it e.g., via training), but now cyber skill is important to the firm.
  - **23 (4%):** *existing directors*, new skill (e.g., training)
  - **199 (35%):** *newly added directors* with cyber expertise

Thus, “specialist” directors explain <u>at most</u> 35% of the newly added cyber skills

1. “Specialist Directors” or “Special Skills”? (cont’d)

Of the 199 newly added directors with cyber expertise…

- How many were *already directors* or had top *executive experience* at other companies?
  - Arguably, generalist directors with a specific expertise (no different from generalist directors with finance expertise, etc.)
- How many are “rookie” directors with functional/technical experience truly in the spirit of *”specialist” directors?* [Outside the “typical” pool]

Why Is the Distinction Important?

1. Important distinction for Promise and Perils Section

Example (Perils):

1. *Individual attributes and group dynamics*
   - More/Only a problem for specialist rookie director?
2. *Authority bias*
3. *Board packing*
   - Problem only if adding new (specialist) directors
4. *Board diversity*
5. *Board washing*
   - Adding new (specialist) directors arguably *less* likely to be a form of board washing

Why Is the Distinction Important? (cont'd)

1. Important distinction for Promise and Perils Section

- Example (Promise):
  - Adding a new specialist director helps with "groupthink" and "escalation of commitment" biases
  - But the other three benefits (resource provision, proactivity, communication, etc.) can be achieved by existing generalist directors acquiring special skills

Why is the Distinction Important? (cont'd)

2. Is this a temporary, one-time shock?

- As time goes by, it seems likely that (the existing pool of) directors will acquire the new types of expertise via their involvement as directors and/or executives in companies facing the issues requiring this type of expertise.

- In other words, it seems likely that within a few years the need for specialist directors (at least with respect to cyber, etc.) will be greatly reduced
  - I.e., trend may be decelerating

- Worth discussing in the paper

Why is the Distinction Important? (cont'd)

3. How to acquire expertise on the board?

- Add a **new** specialist director, or
- Acquire expertise for **existing** directors
  - Training, certification, etc.
  - Learn from management
  - Sub-committee to acquire expertise
  - Learn on other boards

Expertise on the board: continuous, proactive, etc.

- Hiring consultants
- Advisory council of experts
- Internal management expertise

Expertise outside the board: ad hoc, reactive, etc.

Why is the Distinction Important? (cont'd)

- Currently, the study comes across as follows: "*boards are forced to go and recruit new directors with specialized expertise and no exec/board experience, which may lead to numerous problems which may outweigh the benefits*".

- Reframe the problem as: "firms have a **choice** about how to acquire new expertise and will **optimally trade off costs and benefits".**
  - More consistent with your data

- Viewed though this lens, the policy/practical implications will be different

2. What is unique about the new types of expertise?

- Industry-specific
- Marketing/Customer
- Manufacturing/Operations
- Supply chain
- Technology
- Digital Transformation
- Finance
- Accounting
- Legal
- Regulatory issues
- HR
- Etc.

Which ones are the special skills in this study closer to?

2. What is unique about the <u>new</u> types of expertise?

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Climate/AI/DEI(?)
(re-examining
business model)

Cyber/Data
Privacy/Safety(?)
(functional skills)

Why Is It Important?

What is unique about these skills in terms of “Perils”?

- The concern with a “narrow” director unable to contribute to broad board-level issues (strategy, etc.) is valid for functional skills (e.g. cyber), but much less for “sustainability skills” (business model/strategy).
- Also, the “narrow director” concern equally applies to many types of functional expertise (legal, accounting). **Yet, boards figured it out!** Why should be more concerning for “ESG” skills? What is unique?
- Right now, it feels that the “novelty” of these skills is their ESG/stakeholder flavor. But what makes them different from existing skills?
    - **(suggestion) Advocacy vs Expertise?**

3. Standardizing disclosures?

- Let’s agree to disagree!
- “Inconsistencies” in disclosures have good reasons:
  - Number and type of key skills likely to vary by firms
  - What makes someone an “expert” (as needed by a given firm) likely to vary by firm
  - Skill matrix is a firm-specific exercise
- Large accounting literature on the cons of standardization/ harmonization
  - The beauty of voluntary disclosures: you learn about the firm’s perspective
  - Of course, cheap talk is always a concern

4. Sources of Pressure

- Institutional investors seems most important
- Corporate law litigation: interesting, but one case
- Disclosure mandate: Only one example (SEC proposal to disclose if any director is a cyber expert) and the SEC proposal did not go through.
    - On the other hand, final SEC cyber rules require to “describe the board of directors’ oversight of risks from cybersecurity threats. If applicable, identify any board committee or subcommittee responsible for the oversight of risks from cybersecurity threats and describe the processes by which the board or such committee is informed about such risks.

4. Sources of Pressure (cont'd)

- Disclosure mandate: another example you can add
  - SEC climate disclosure rules require disclosure of how the board is informed of climate-related risks (e.g., through presentations from the reporting entity's management, third-party experts, board members with expertise, other mechanisms) and require to identify the committee charged with responsibility for overseeing climate-related risks
- In other words, reframe discussion in terms of disclosure mandates of board oversight rather than (only) disclosure mandates of the presence of a given expertise

4. Sources of Pressure (cont'd)

- Study seems to ignore importance of customers, employees, and society in general
  - Arguably, the pressure behind institutional investors, regulators and courts starts with these stakeholders

- Also, the study underplays the role of boards' self-reform
  - Many boards acted without direct input from investors, regulators, or courts (*external*).
  - Arguably they did it in response to or anticipation of societal pressure

Other comments/suggestions

- Figure 5: absolute increase partly driven by increase in firms with skill matrix. Replace with:
    - % of directors in a skill matrix with a given expertise
    - % of firms (with skill matrix) with at least one director with a given expertise

- "Blackrock and State Street have updated their voting policies and declared publicly that boards should include directors who are experts in sustainability"
    - Clarify the voting policy

Other comments/suggestions (cont'd)

- More on: **What constitutes expertise?**

- Suggestion: create Appendix with few examples of how companies conclude a director possesses "expertise" in cyber, climate, DEI, etc.
  - Is it experience running a company facing a cyber issue?
  - Is it experience as director on such company?
  - Is it technical expertise acquired as functional manager (CISO?) Other types of technical expertise?
  - Is it educational background?
- How does the answer differ across skills (e.g. cyber vs. climate)?

Other comments/suggestions (cont'd)

- Bio vs skill analysis on p.23: how many of the 275 directors are newly added ones? (I suspect the majority)
- Drop the "ideal skills" and focus on skill matrix
- Term "general skills" table is confusing
- Recognize potential selection bias in skill matrix sample (voluntary disclosure)