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DIRECTOR FAQ
February 2022

The Role of the Board vs. the Role of Management

IN BRIEF

As the corporation's ultimate decision-making body, the board of directors has both an oversight role (overseeing management on behalf of shareholders and other constituencies) and an advisory role (advising management), with limited involvement in every-day company operations.[1] NACD's founding president, John Nash, coined the term "nose in, fingers out" (NIFO) to capture this important distinction between observation and advice, versus action. By contrast, members of management are full-time company employees whose main responsibility is to operate the company. This memo explores the differences and overlaps between the roles of directors and managers in for-profit enterprises.

Q: How do board and management roles differ? Where is the dividing line between them?

A: This memo answers this question by addressing the following topics:

1. ROLE OF DIRECTORS

Boards and their members must comply with established state laws, listing exchange requirements, and other regulations as prescribed by federal law. Boards also must comply with their established charters, bylaws, and governance guidelines. A good list of directors' legal duties can be found in state corporation statutes. Delaware General Corporation Law, for example, states that the "business and affairs" of corporations "shall be managed by or under the direction of a board of directors;"[2] it lists certain corporate decisions that can only be made by the board. This broad mandate for the board is consistent with laws of other states. It is also consistent with the Model Business Corporation Act of the American Bar Association, which guides the statutes of many states.

[1] This memo provides information on unitary or single-tier boards of directors. For recent guidance on dual board structure, see Klaus J. Hopt and Patrick C. Leyens, "The Structure of the Board of Directors: Boards and Governance Strategies in the US, the UK, and Germany," posted April 12, 2021, on the *Harvard Law School Forum on Corporate Governance* blog.

[2] Delaware General Corporation Law, Subchapter IV., § 141.

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State corporation statutes often list actions that can only be performed by full boards and that cannot be delegated to a board committee:[3]

- Charter amendments
- Plan of merger or consolidation
- Sale, lease, or exchange of all the company's assets
- Dissolution of the corporation

In addition, under federal securities laws pertaining to public companies, boards are responsible for

- registration statement liability under the Securities Act of 1933,
- oversight of US Securities and Exchange Commission reporting under the Securities Exchange Act of 1934, and
- compliance with stock exchange rules pertaining to boards and their committees.

Many other board responsibilities may either be carried out by the full board or delegated to a board committee:

- Declaration of dividends
- Approval of derivative litigation
- Compensation of directors
- Compensation of officers
- Election of officers
- Issuance of stock, stock options (or rights), and retirement of stock
- Indemnification of officers, directors, employees, and agents
- Reduction of the corporation's legal capital

The nature and structure of director compensation underscores the director's role as a fiduciary, rather than as a manager (who may or may not have fiduciary duties). Directors do not work full time, and indeed should not for purposes of independence. NACD recommends that boards of all company types be composed of a majority of independent directors so that they may properly hold management accountable on behalf of shareholders.[4] Independent directors do not receive salaries or bonuses; instead,

[3] See Delaware General Corporation Law, Subchapter IV., § 141. See also National Association of Corporate Directors (NACD), Customizable Director Role Description (Washington, DC: NACD, 2016).

[4] National Association of Corporate Directors (NACD), *Report of the NACD Blue Ribbon Commission on Director Professionalism* (Washington, DC: NACD, 2011), p. 9. Note: Companies listed on the New York Stock Exchange must have audit, compensation, and nominating/governance committees composed entirely of directors who are independent, which precludes employment and consulting arrangements with the company. Nasdaq's *Continued Listing Guide* (p. 5) has similar requirements, with some flexibility for the nominating process.

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directors are compensated by retainers and/or, more rarely, meeting fees.[5] All directors are paid at the same rate for the same functions. There are no variations of pay based on individual performance since the board works as a collective group, with all directors having the same fiduciary duties and the same exposure to liability.

In recent years, the role of the board has been trending toward greater involvement in issues previously reserved for management, such as strategy.

To keep the dividing line between responsibilities clear, it is important to have a protocol to differentiate the board's role versus management's role in regard to strategy development. For a list of common expectations of directors, see the *Customizable Director Job Description* and Sample Corporate Position Descriptions listed in the NACD Resources at the end of this memo.

2. THE ROLE OF MANAGEMENT

The role of management differs substantially from the role of directors. Although directors all have similar job descriptions for their work, there is no single playbook for managers. A wide variety of officers can be appointed and compensated by directors, and their roles can be whatever the board approves.[6]

Managers, as officers, are elected, compensated, and indemnified by the board. As such, the board is a higher authority to which managers report. However, the distinction between directors and managers is more than hierarchical. As mentioned earlier, directors' duties can generally be referred to as fiduciary in nature. By contrast, although managers do have some fiduciary duties, their roles are not exclusively fiduciary but also operational, since they perform the day-to-day work of the organization.

The CEO's role is a key determinant of the board/management relationship. He or she is the highest-ranking manager and often serves as the board chair. This use of managers to chair the board can lead to some confusion between the roles of management and the board. Where CEO and chair roles are combined, NACD recommends that boards appoint a lead director to represent independent directors.

[5] For more information on director compensation, including the use of meeting fees, please reference the *2020–2021 Director Compensation Report* (Arlington, VA: NACD, 2021).

[6] Common roles for officers within the senior management include the CEO, chief operating officer, chief financial officer, and chief legal officer or general counsel. Other C-suite roles have grown in prominence in recent years, such as the chief information officer, chief information security officer, and chief risk officer.

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3. THE INTERRELATIONSHIP BETWEEN DIRECTORS AND SENIOR MANAGERS

Directors and senior managers (who are often designated officers) have roles that overlap in a number of circumstances:

- Directors and officers are often considered jointly as fiduciaries for the purposes of "D&O" indemnification and insurance. As stated by *Black's Law Dictionary*, citing case law, a person is a fiduciary if he or she is "invested with rights and powers to be exercised for the benefit of another person."[7] As fiduciaries, both directors and officers have duties of care and loyalty, and may be protected in their decisions by the business judgement rule.
- The roles of directors and senior managers may be seemingly identical in some companies, as in some privately owned start-ups where boards are composed entirely of managers who also are owners.
- The CEO may also serve as the board chair, which has the potential to blur board and management roles, at least symbolically.
- Crises or other special circumstances may require the board to go beyond its traditional duties to take on roles typically reserved for management.

These factors make it all the more important to draw a distinct line between the role of managers and the role of directors. This is particularly true when there is a separation of ownership and management, such as in the case of public companies, where professional managers are presumed to be agents for shareholders but may instead act in their own interests. Directors play an important role by ensuring that managers act in the interest of shareholders and other stakeholders, rather than in their own interests.[8]

According to this so-called *agency theory*, a key role for directors is to ensure returns to shareholders through dividends and/or stock appreciation.

Agency Theory

Widespread equity ownership by nonmanagers in public companies creates a risk of management self-enrichment at the expense of shareholders. Unless they own all or most of a company's stock—which is rarely the case with public companies even when pay is awarded in stock—managers may be unlikely to give long-term shareholder returns the same level of attention as their own annual pay. When there is a division

[7] Svanoe v. Jurgens, 144 111.507, 33 N. E. 955; Stoll v. King, 8 How. Prac. (N. Y.) 299, cited in *Black's Law Dictionary* online.

[8] In the governance classic, *The Modern Corporation and Private Property* (1932), Adolf A. Berle and Gardiner C. Means noted the rise in equity ownership by nonmanagers of corporations. This set the stage for the development of agency theory to describe the relationship between agents and principals, and the conflicts and risks that arise between them.

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between owners and management, directors can ensure that the agency relationship works as intended—for example by ensuring returns to shareholders through dividends and/or stock appreciation.[9]

4. OVERCOMING CHALLENGES IN THE BOARD/MANAGEMENT RELATIONSHIP

Over the years, through various meetings and research initiatives, NACD has found a number of common challenges in maintaining a positive board/management dynamic:[10]

- **INEFFECTIVE COMMUNICATIONS:** The management team should not hide information but openly share it with the board; conversely, the board and its committees should be forthcoming in communicating concerns and needs to management.
- **OVERSTEPPING BOUNDARIES:** The board should not attempt to run company operations; it should oversee how management runs the company. By the same token, the board should not be pressured by management when it has reservations about proposals and ideas.
- **ADDICTION TO SHORT-TERMISM:** Neither management nor the board should focus on short-term performance at the expense of long-term value.

Boards can overcome these challenges and encourage good board/management dynamics by taking these actions:[11]

- Promote an open exchange of information by interacting with management in formal and informal settings.
- Reinforce accountability through effective questions and clearly communicating the board's expectations and performance goals.
- Designate an independent board chair or lead director, who does not hold an office within company management, to provide fully independent leadership of key boardroom processes and discussions.
- Interact with management beyond the C-suite to better understand the company's business and management.
- Be alert for signals of excessive focus on short-term performance objectives and work together to recalibrate goals so that they are oriented to the long term.

[9] For more details on the application of agency theory to modern corporate governance, see J. Bendickson, J. Muldoon, E. W. Liguori, and P. E. Davis (2016), "Agency theory: background and epistemology," *Journal of Management History*, 22(4), 437-449.

[10] Adapted from National Association of Corporate Directors (NACD), *Director Dialogue: The Board's Evolving Relationship With the C-Suite* (Washington, DC: NACD, 2016), pp. 3–4.

[11] Adapted from various resources in the "NACD Board Dynamics and Operations Resource Center."

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5. KEY QUESTIONS FOR BOARDS

- Are the roles of directors and management clearly defined? Do we have director and management job descriptions to make the dividing line clearer?
- How can our leadership structure work to delineate and support an independent leader of the board?
- How does the board communicate with the management team, both formally and informally? What is the CEO's role in this line of communication?

6. RECOMMENDED ACTION STEPS

1. Design the director onboarding process to include education on directors' fiduciary duties; state and federal laws and their implications for directors; and the difference between the role of a director and the role of a manager.
2. Develop and update a director role description and provide it to board members. (See the Customizable Director Role Description in the NACD Resources section below.)
3. Review board leadership roles and their responsibilities (CEO, chair, lead director, and committee chairs). Identify and mitigate areas of overlap or gaps in their responsibilities.
4. Communicate with management about the role of the board and set appropriate expectations for the role that the board will fulfill. Where appropriate, establish protocols to establish which decisions the board is responsible for making and which can be delegated to management.

7. NACD RESOURCES ON THE ROLE OF THE BOARD

- *2020-2021 Trends and Priorities of the American Boardroom*
- *2021 Inside the Private Company Boardroom*
- *2020–2021 Director Compensation Report*
- *Update of the Diverse Board: Moving from Interest to Action (2020)*
- *Fit for the Future: An Urgent Imperative for Board Leadership (2019)*
- *Adaptive Governance: Board Oversight of Disruptive Risk (2018)*
- *Director Dialogue: The Board's Evolving Relationship With the C-Suite*
- *Customizable Director Role Description*
- *C-Suite Expectations: Understanding C-Suite Roles Beyond the Core*
- *Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies*

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- *Report of the NACD Blue Ribbon Commission on Board Leadership*
- *Report of the NACD Blue Ribbon Commission on the Board and Long-Term Value Creation*
- *Report of the NACD Blue Ribbon Commission on Director Liability*
- *Report of the NACD Blue Ribbon Commission on Director Professionalism*
- *Sample Corporate Position Descriptions*

8. ADDITIONAL RESOURCES

- Delaware General Corporation Law, Subchapter IV., § 141
- American Bar Association, Model Business Corporation Act

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