

# *THE FLIGHT OF THE AMERICAN CEO*

By Jim Drury

There is something unexpected happening in America's boardrooms that may be undermining the health of America's leading public companies. Ironically, as the importance of corporate boards to the well-being of the companies they lead has been clearly established and independent directors have gained greater power and authority, there is a shrinking pool of the most experienced and talented director candidates. Since 1990, the number of active CEOs sitting on the boards of other companies has declined dramatically. The data is incontrovertible – there's been a stealth revolution underway for the last 16 years that has been robbing American companies of some of the most important and sought-after board members.

Make no mistake; boards today remain populated by highly accomplished people with a broad and relevant mix of experience. Highly motivated retired executives, emerging executives, investors, retired government officials, former military officers, college presidents, foundation presidents, and myriad not-for-profit leaders today guide America's corporations. However, more and more frequently, active CEOs from leading companies are unavailable to serve on the board of another company and fill a very important seat at the table.

For decades, active CEOs have anchored many boards, but that is changing fast. Today, CEOs face mounting pressure “to stick to their knitting” and focus virtually all of their attention on running their own companies. Some may see this as a healthy development, but it is not without a cost. With more and more CEOs limiting, or altogether foregoing service on other company's boards, a vital source of knowledge and “real world” experience has become a scarce resource. As a result, board deliberations may be less well-informed, sitting CEOs lose access to a potentially helpful personal advisor and corporate oversight is arguably weakened.

The flight of the CEO from the boardroom has important consequences for American companies and investors, and may be undoing the well-intended efforts of corporate governance activists and government officials to fortify corporate oversight. The dimensions of the CEO exodus and some of the potentially harmful effects are the subject of this first of three articles on the “state of the boardroom.” It also addresses some of the unintended consequences of the “governance movement,” which has as its laudable goal stronger protection for shareholders and greater transparency, but may be having the opposite effect.

## HOW IN TOUCH ARE YOU?

As a firm that specializes in the recruitment of board directors, James **Drury** Partners closely studies boardroom trends. There is a common perception by corporate watchdogs that many CEOs take on too many outside board appointments. However, our experience and new data show that's not the case. In fact, the opposite is true. In recent years, CEOs have pared back on their board memberships and are backing down from four, and perhaps three, to two boards on the average. We invite you to answer the same question we have been asking our clients for a number of years: “What number of outside boards does the greatest number of active CEOs serve on today - 0? 1? 2? 3? or more?”

If you said “2,” you are in the majority—but slightly out of touch.

If you said “1,” you are better informed than most but still incorrect.

If you said “0,” you have rare insight and are absolutely correct.

**THE TREND**

Having noted in our board director recruitment work a growing reluctance on the part of CEOs to consider new board appointments, we decided to look into this pattern more closely. We recently completed an in-depth study of the board service patterns of active *Fortune* 500 (F500) CEOs over the past 16 years. We began our analysis with the year 1990. That is the year we regard as the dawning of the “modern corporate governance

***There may be no Fortune 500 CEOs serving on outside boards by 2016.***

age” – the time when shareholder activists and institutional investors began to take center stage in questioning the

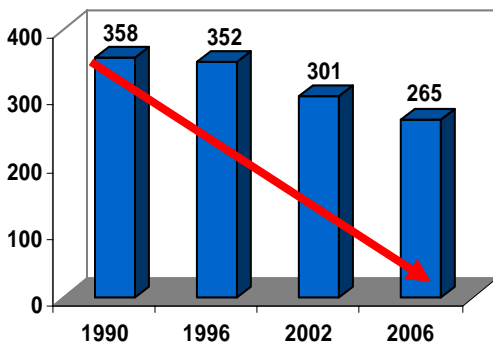
performance of corporate boards. We were startled by the results of our study as we found that more than just paring back involvement, active CEOs are abandoning board service altogether at an alarming rate.

In 1990, 358 active CEOs, or 72% of the F500, served on outside boards. Today, according to SEC filings and annual reports available in June 2006, only 265 active CEOs, or 53% of the F500, serve on outside boards, a decline of 26%.

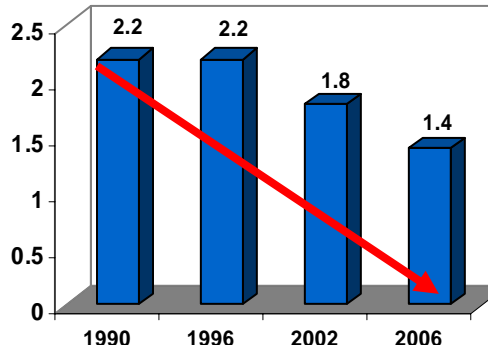
We also found that active CEOs who continue to serve have reduced their outside board commitments from an average of 2.2 boards to 1.4 boards, a decline of 36%. These two trends in combination have had a devastating effect on the “willing capacity” of active CEOs to contribute professionally as outside directors. The net result is surprising. In 1990, F500 CEOs filled 794 outside board seats. Today the number has fallen to 376, a decline of 53%. That is 418 seats at the board table that have been abandoned by the leaders of the American business community – a brain drain of considerable proportion. The retreat continues at an alarming pace. In the five-year period of 1997-2002, 51 CEOs left the field of play. In the next four years, 2002-2006, another 36 departed. In short, during the last nine years, CEOs have pulled up stakes and stopped serving on outside boards altogether at an average rate of approximately ten per year.

The following table graphically depicts the above trends. It shows the historical data for the following 4 years: 1990 (the dawning of governance), 1996 (halfway to Sarbanes-Oxley), 2002 (Sarbanes-Oxley), and 2006. While the number of board seats filled by CEOs declined by 253 in the five-year period, 1997-2002, or 32%, it declined by 162, another 30% in the last four years.

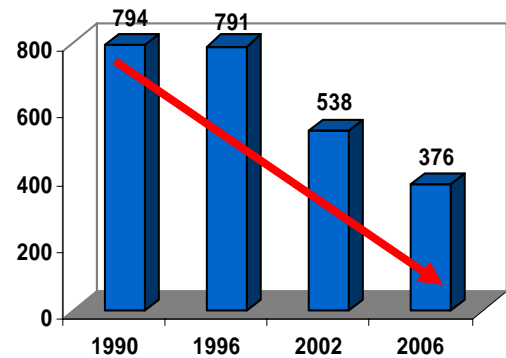
**CEOs Serving on Outside Boards**



**Average Directorships per CEO**



**Total Board Seats Filled by CEOs**



Hypothetically, if the above trend lines continue, there may be **no active F500 CEOs serving on outside boards by 2016** -- just ten years from now. While the prospect of no F500 CEOs serving on outside boards seems exceedingly unlikely, one has to wonder what events could possibly reverse this trend. The prospect of not having the knowledge, experience and credibility of a single F500 CEO available to advise top management and other board members is a truly disconcerting outcome. Perhaps this is an unintended consequence of the corporate governance movement and the demands now being placed on sitting CEOs by new, more stringent corporate regulations. Had this possible outcome been a prediction in 1990, we suspect that not a single governance expert would have thought it plausible.

### **THAT WAS THEN**

In times past, active CEOs considered outside board service an honor and a privilege. It was not unusual to find active CEOs serving on four, five, six or, in rare instances, eight outside boards. The larger and more impressive the CEO's company, the more coveted he or she was as a director, and the more invitations he or she received and accepted. In 1990, large company CEOs collectively filled more board seats than CEOs of lesser size companies. CEOs of F100 companies filled 208 seats, while CEOs of companies ranked 401 to 500 filled only 109.

As the performance of CEOs and boards has become more closely scrutinized by the investor community and critiqued in the business press, it is now clear that CEOs have not only backed away from board service, but also left the playing field altogether.

In 1990, eight of the CEOs running "top 10" F500 companies served on outside boards, filling 16 board seats. For example, Roger Smith of General Motors served on four outside boards, and Lawrence Rawl of Exxon Mobil and Ed Woolard of Dupont, each served on three. The only "top 10" CEOs who did not serve on outside boards were Jack Welch of General Electric and Lee Iacocca of Chrysler.

Today, eight of the "top 10" CEOs sit on no outside boards whatsoever. The two that do serve sit on one board each

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–Citigroup's Chuck Prince sits on Johnson & Johnson's board, and IBM's Sam Palmisano serves on Exxon Mobil's board. In other words, we now have 87% fewer board seats filled by the "top 10" CEOs than in 1990.

***87% fewer board seats filled by the "top 10" CEOs compared to 1990***

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If we expand this elite CEO group to the "top 20" F500 companies, the picture changes only slightly; although it remains clear that CEOs of the very largest U.S. companies are now on the sidelines. In 1990, 18 of the "top 20," or 90%, served on outside boards, filling 37 seats. Today only seven serve on outside boards, filling eight seats, a reduction of 78% in contributed board capacity.

### **THIS IS NOW**

How different is the landscape today in terms of the board workload that CEOs are willing to assume? Even with these trends, our board clients continue to feel it is important to recruit active CEOs for their boards. What is the likelihood of success given the diminishing appetite CEOs have for board service?

It is difficult to say, in view of the fact that so much has changed since 1990. Then, 51 of the F500 CEOs served on four or more boards, with the most active CEO being Carl Lindner of Penn Central, who served on eight outside boards. Not far behind, on six outside boards, were David Kearns of Xerox, Lawrence Tisch of CBS, Roger Stone of Stone Container, and Charles Ames of Uniroyal Goodrich. By 1996, six years later, the number of CEOs on four or more boards actually grew to 56, with Walter Scott, Jr., CEO of Peter Kiewit, serving on eight boards. He was closely followed by John Clendenin of Bell South and Bill Stiritz of Ralston Purina on seven outside boards.

The situation changed dramatically over the following six years, as governance scrutiny moved to the forefront and Sarbanes-Oxley legislation was passed in 2002. During that period, the

number of F500 CEOs on four or more boards declined 73% to only 15.

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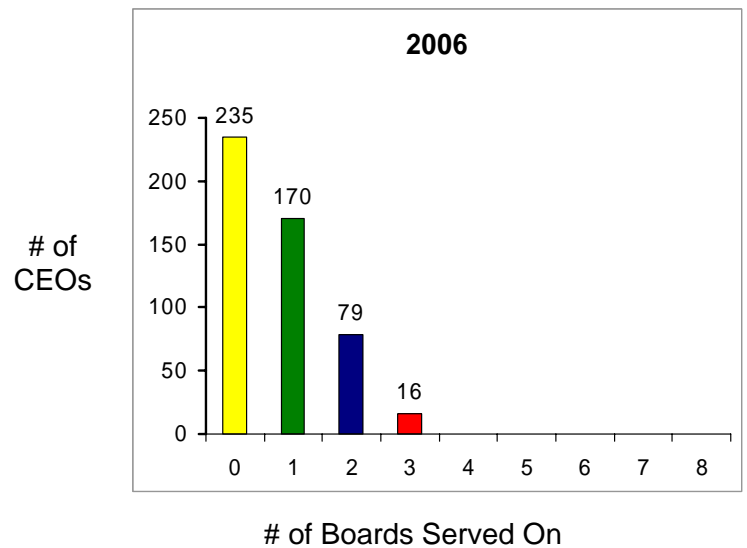
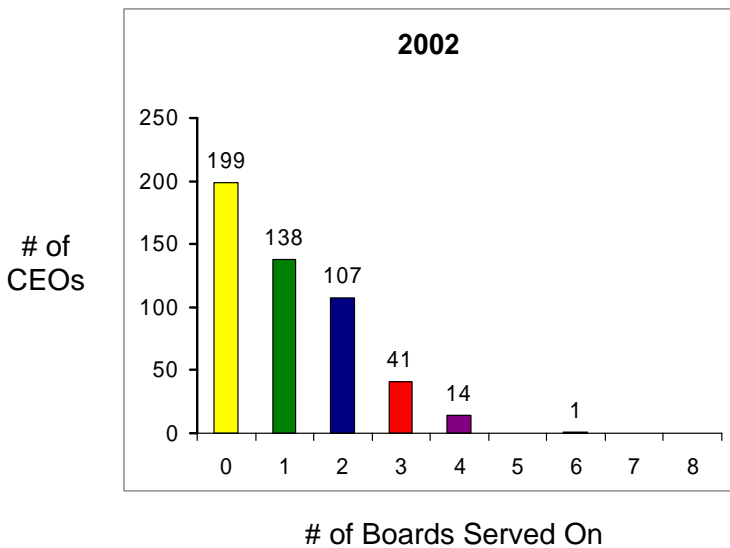
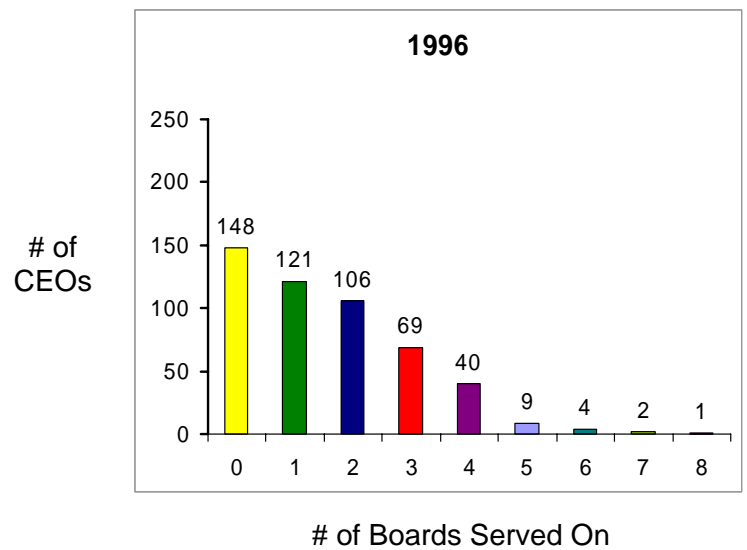
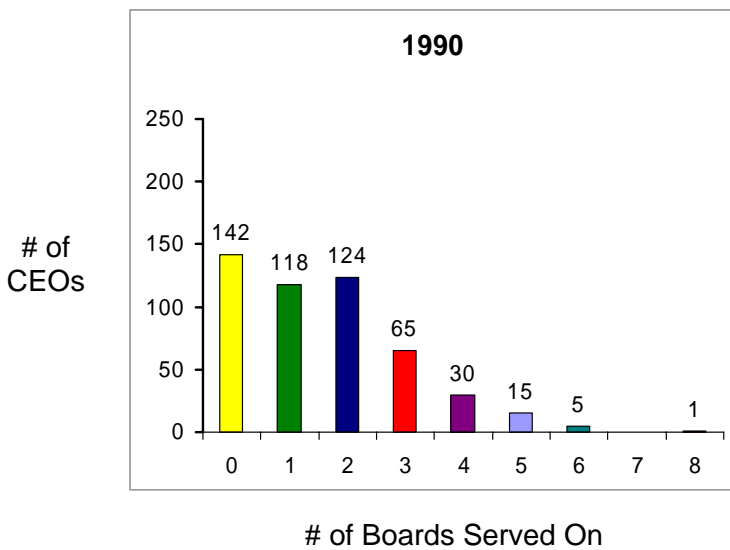
***Today, 235 Fortune 500 CEOs serve on no outside boards whatsoever.***

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Today, in 2006, there are no CEOs serving on four boards or more. In fact, since 2002, the number of CEOs serving on three or more boards has declined by 38 - from 56 directors to 18, a

drop of 68%. In 1990, only 142 F500 CEOs did not serve on outside boards. Today, the number of CEOs on the sidelines has grown by 65% to 235. We are now at a point where 47% of F500 CEOs contribute none of their valuable business acumen to outside boards.

The following charts depict the shifting pattern of CEO board service by number of outside boards during the years 1990, 1996, 2002, and 2006. The evidence portrays the retreat of CEOs from “two or more” boards to “one or none.”

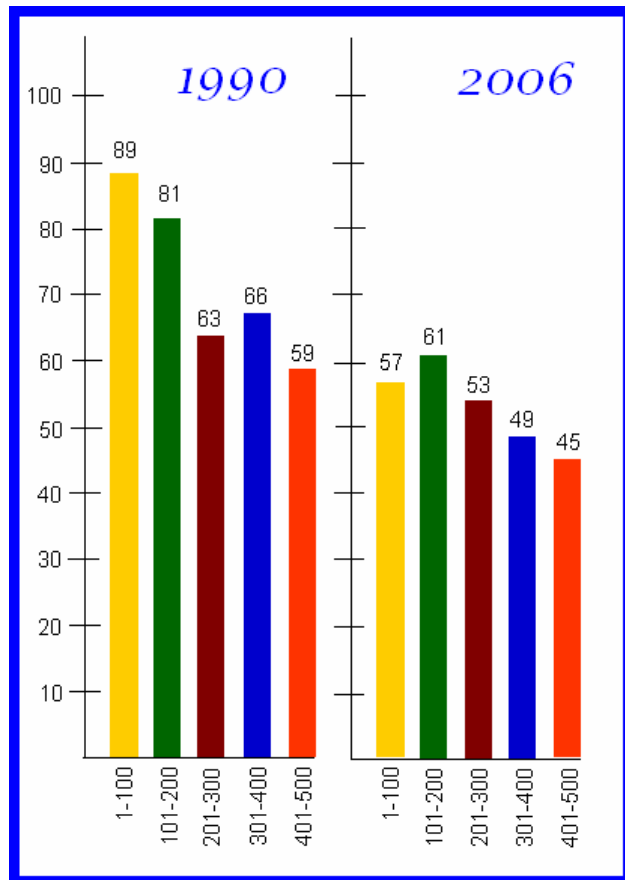


**CEOs UNDER THE MICROSCOPE**

Across the board, those CEOs who continue to serve are cutting back on their outside director commitments, regardless of their company’s size. CEOs of the largest F500 companies (ranked 1-100), served on an average of 2.3 outside boards in 1990, and today serve on only 1.3. CEOs of the smallest F500 companies (ranked 401-500), served on 1.8 in 1990, and today serve on only 1.4. So, whereas there was some variability by company size – i.e., large company CEOs serving

on more boards than smaller company CEOs – today, all CEOs average about 1.3 to 1.5 boards. This raises a very interesting question for boards attempting to recruit a CEO as a director. Most boards want CEOs who have experience as an outside director, rather than serving as their training ground. The trend analysis shows that may no longer be possible. If you desire an active CEO on your board, the reality is that you may have to offer that CEO his or her first outside board position, because they are unlikely to go on more than one – if you can get them at all.

	<u>1-100</u>	<u>101-200</u>	<u>201-300</u>	<u>301-400</u>	<u>401-500</u>
1990	2.3	2.3	2.4	2.1	1.8
2006	1.3	1.5	1.4	1.4	1.4



**Total Number of CEOs on Boards By Company Size**

**LARGE COMPANY CEOs LEADING THE EXODUS**

In 1990, CEOs of large companies were by far the most popular directors and the most likely to accept an invitation to serve. Eighty-nine of the F100 CEOs served on outside boards, while only 59 of the 100 smallest F500 companies’ CEOs did so.

Much has changed since then. Over the past 16 years, 32 of the F100 company CEOs have withdrawn from the board playing field. By comparison, only 10 of the middle F500, and 14 of the smallest F500 have removed themselves from service.

The distribution of board seats has also shifted dramatically over the years. In 1990, the CEOs of the top 100 companies accounted for 208 board seats, 151 for the middle 100, and 109 for the bottom 100. Those who did not abandon board service altogether did, nevertheless, reduce their board commitments. While there was some shifting across groups, CEOs in all company-size groups have migrated to a lower level of board service, with the various groups filling between 64 to 89 seats, compared to 109 to 208 seats in 1990. In 1990, the top 100 CEOs filled the greatest number of board seats, 208. Today, they fill only 77 seats, while 101-200 company-ranked CEOs now fill the most – 89 seats.

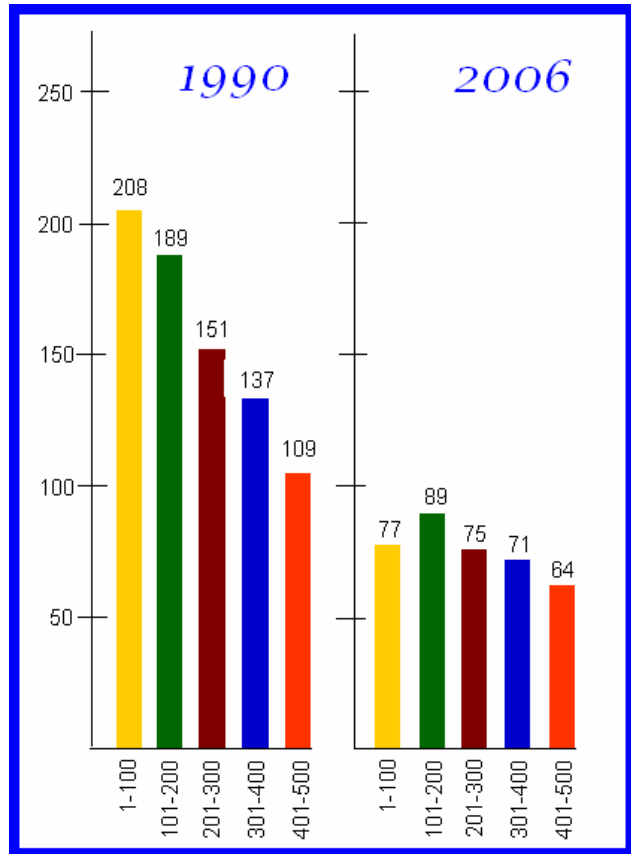
The degree of reduction in board seats filled by the various size groups has been very consistent within a narrow bandwidth, with the largest 100 F500 CEOs cutting back their board seats filled by the greatest amount, 63%, and the lowest 100 F500 CEOs by the least amount, 41%.

The retreat from board service has been primarily led by the CEOs of the largest F500 companies. These tend to be the companies with the greatest shareholder value, the most publicity, and are the most likely targets for governance scrutiny. Consequently, the boards of these companies have applied the most pressure on their CEOs to cut back their time commitment to outside board activities, urging these CEOs to focus all of their energies on enhancing the performance of their own companies.

Clearly, the boards of these companies have concluded that they must limit the outside involvements of their CEOs to demonstrate to shareholders and investor activists that their CEOs are focusing all of their attention and energy on the business at hand.

**CAUSE FOR CONCERN**

These trends raise real questions about the future strength of our corporate governance system. Most experienced directors consider active CEOs to be the mainstay of the modern corporate board. They are the only directors who have current, real-time experience grappling with the



**CEO Board Seats Filled By Company Size**

same modern day business issues that confront the CEO of the company on whose board they serve. They are a great source of insight, providing alternative perspectives on almost any business question. They are the directors that other directors, and the CEO, can turn to for objective CEO-level perspective and counsel.

They can also help the board maintain its focus on the issues, if it loses sight of the issues at hand. As a board member, an active CEO will have great credibility should he or she need to advise the company's CEO -- privately and persuasively -- to rethink his or her position on a significant issue.

Boards, in general, are largely populated with non-corporate executives. Most directors will freely acknowledge that in times of great challenge, their attention tends to turn to the active CEO director for his or her experience and judgment.

Unfortunately, as active CEOs continue to reduce their board commitments, the board seats they once filled are increasingly vacant. CEOs and experienced board directors with whom we have spoken are highly concerned that the accelerating erosion of CEO board service represents a major weakening of the American governance system. Without one or two active CEOs in the boardroom, the board's point of view is often based on hypothetical thinking rather than "skin in the game" experience.

There is also the view that outside board service strengthens the insight and perspective that a CEO brings to managing the affairs of his or her own company. If an appropriate company is selected when accepting a board role, it can provide invaluable experience in addressing major business issues that the CEO's own company may face, such as international expansion, global sourcing, acquisition integration, product innovation, technology enhancement, brand building, etc. It can also provide insight into the appropriate role of a board director and the demands faced by boards today, enabling better appreciation and understanding of the type of relationship the CEO needs to have with his or her own board. Without board service, CEOs lose the rare opportunity to learn valuable lessons.

One of the real ironies is that boards often seem to be on both sides of this issue -- apparently wanting to have their cake and eat it too. When searching for a new director, their first preference is often an active CEO. And while they may be actively searching, these boards are, at the same time, advising their own CEO to decline outside board opportunities. There seems to be little acknowledgement that the experience and insights gained could make the CEO more effective in the

leadership of his own company. Some boards seem to feel that it makes perfectly good sense to recruit the CEO of another company as a director -- simply do not expect them to allow you to recruit theirs.

Underlying all of this, we believe there is a very deep responsibility to broader interests. Our American business system is a modern wonder that is widely admired and emulated around the globe. It has spawned many great companies whose products and services have changed the world. Boards must recognize that it is not only their role to govern the companies for which they serve, but also to protect and nurture a business system that has helped their own companies thrive. Part of that responsibility is to ensure that all boards, wherever they may be, have the strongest directors possible to assure good governance. Boards must be very careful that they do not "kill the goose that laid the golden egg" by arbitrarily constraining their own CEOs from accepting reasonable opportunities to serve.

We recognize that there is more pressure on CEOs to perform than ever before and more pressure on boards to hold them accountable for such performance. While that's a good thing, it's not the only thing. With respect to the CEO's allocation of time, boards find themselves between a rock and hard place. While the safest short-term course of action may be to require that CEOs focus all of their energy internally, in the long term this creates a situation in which active CEOs disappear from the American boardroom, thereby weakening the quality of all corporate boards.

### **SIMPLY THE INITIAL PHASE OF A MORE TROUBLING SEISMIC SHIFT**

Many will say that declining CEO board service is not a major problem -- there are plenty of qualified people willing to fill these seats and this concern will pass. We disagree. The flight of CEOs from board service may be part of a larger, more troubling scenario that is playing out: the demise of the publicly traded corporation as we know it today, and a diminishing opportunity for the small investor to be a shareholder.

Increased governance activism is apparently not without a price. One of the themes of the recent movie *Glory Road*, which chronicled the march of the Texas Western basketball team to the national collegiate championship in 1966, was that an elite team of superb athletes can be so over-coached, over-managed and over-controlled that their natural talents are suppressed and they never realize their full potential. The same may be true for talented leaders of American corporations. An over-managed, over-inspected environment may be hobbling talented CEOs who are not being allowed to use their finely-honed natural instincts to their fullest extent. Great advancements in athletics and in business do not occur by very modest, measured steps. They require bold moves

the necessary risk associated with embracing change, following new paths, and experimenting with new concepts considered essential for continued growth and prosperity. So, while we hear from CEOs that they are deciding to retreat from board service, because the risks – however you define them - are simply not worth it. That is just part of the unfolding story.

We have also heard from a large part of the executive talent pool that many potential CEO candidates have no interest in becoming CEOs of publicly-traded companies. Additionally, for the first time, we are learning that a growing number of executives express a greater interest in being the CEO of a private company, quite the opposite of the case prior to 1990. Why? Because there is a strong conviction that it is becoming easier to build a great company that is private, than one that is public. Having the freedom of operating in an environment in which every strategic and tactical move does not have to be explained to shareholders, investment analysts, and governance activists is proving to be a powerful lure.

In fact, there is a strong feeling among CEOs that we will begin to see a growing number of important, publicly-traded companies going private, simply to avoid unproductive regulation and scrutiny under the public microscope. In just the last few months, we have begun to see ample evidence of that as some very large public corporations – e.g., ARAMARK, Kinder Morgan and Ford – have announced their intentions to explore “going private,” financed by major banks, investment banks and LBO consortiums. That is the larger scenario that we believe just might be playing out here. So, get ready.

The ultimate irony of the rise of the governance movement is that it has grown in influence without any reasonable understanding of when “enough is enough.” The effect of this may well be that governance activists may be pushing American industry toward a business system in which their stated goals are subverted. There may well be:

- a weakened governance system, as the most accomplished business leaders among us continue to

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***Minimizing risk,  
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entailing some degree of risk. Our great American economy was created

by freethinking entrepreneurs who were able to see things that others could not visualize and understand things that others could not grasp. Doing the safe and obvious has never lifted Man’s soul or sent his spirits soaring.

As we have spoken with CEOs and directors about our observations, they express very clear concerns – not only about the financial cost of governance, but also about the opportunity cost. The growing structure of governance policies, procedures, reviews and approvals is believed by many to be lowering the level of risk that boards and CEOs seem willing to embrace in the interest of progress. There is less tolerance for mistakes and no tolerance for surprises. A company missing quarterly earnings forecast by two or three cents, can see an immediate market cap collapse of 10-20%. For a growing number of companies, minimizing risk, rather than managing risk, seems to be the board’s mantra.

For boards fearful of having to explain a mistake or misjudgment to shareholders, inertia has become an ally. Oftentimes, it seems easier – safer—to hamper CEOs with questions about the minutia of management strategies, rather than empowering them to act. Carried to an extreme, boards will stifle management’s ability to assume

remove themselves from board service,

- less transparency of actual business performance, and fewer companies to govern, as a growing number of important public companies are taken private,
- and a diminished opportunity for the small investor to own a piece of the American business dream. Unable to meet minimum

investment criteria required by banks and investment firms who will be collaborating to take these companies private, small investors will not have the opportunity to own a piece of some of the country's most promising enterprises.

With CEOs abandoning the boardroom and companies going private it is clear that "Too much of a good thing, is never a good thing."

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This is the first in a series of three articles to be published by James **Drury** Partners on the serious implications of the "*The Flight of the American CEO.*"

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Our founder and CEO, Jim Drury, has actively provided corporate governance counsel for over

20 years, having founded the annual corporate governance forum, *Toward Common Ground*, at Northwestern's Kellogg Graduate School of Management and *The Directors' College* at the University of Chicago's Graduate School of Business.

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