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of

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at a Luncheon of the

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In this short, but very pleasant visit to Texas, I have seen many evidences of the fact that Texas is one of the coming industrial states of the Union. Here, where the spirit of the frontier is still strong, where natural resources are still being developed and new markets are still to be explored, I find a more active, a more progressive outlook than is evident in some older sections of the United States. And Texas business is every day demonstrating that the spirit of the New Deal is altogether compatible with the spirit of progressive and enlightened industry. It is only when industry is overshadowed by the old customs of the past that it is resistant to the new requirements of change. Texas industry, developing at a healthy distance from influences which tend to be more financial than industrial, owes little to the past and should therefore contribute much to the future.

It is indeed because of this atmosphere of industrial progress and political Democracy that I am encouraged to speak of an idea which has not recently been much discussed in the public forum. Because it is still a tentative idea, I am mentioning it merely as a suggestion. I offer it in an altogether unofficial capacity. And I propose it not as a legislative program but as a program for industry itself.

What I have to suggest deals with the need for making the Boards of Directors of American corporations more actively interested in their duties, more familiar with their companies and more responsive to the interests of the stockholders whom they theoretically represent.

That directorates, as they are now made up, have their serious shortcomings will not, I think, be disputed. We can all remember, back in the boom days, numerous examples of directors who did not direct. And only a few weeks ago a major scandal in a famous and highly respected New England concern showed that for years there was a real skeleton in its corporate closet of whose existence even the board of directors apparently was not aware. To be sure, no system is proof against individual dishonesty. But it is possible to make the way of the transgressor or the careless man a little harder and his career considerably more brief. Honest and capable directors and managements constitute an overwhelming majority. But it is often impossible for directors to exercise the functions of counsel, of guidance and of restraint. And the consequences of error, however honest, are often more serious than the consequences of deceit.

Many of the deficiencies of our modern directorates result from the presence of so many inactive directors on so many of our larger boards. In many of our directorates there are business colonels of the honorary type - honorary colonels who are ornamental in parade but fairly useless in battle; men whose fathers and uncles perhaps were generals but who themselves are qualified to command only by the virtue of the uniform they wear.

Joseph P. Kennedy, who was the first chairman of the S. E. C. and is now our Ambassador to Great Britain, recently said to me:

"In this country, while in legal theory the directors supervise the management, too often we have witnessed in practice what amounts to an abdication of directorate responsibility. The last few years in particular have revealed surprising failures on the part of American directors to live up to the responsibilities of their jobs. One obvious reason is of course the fact that the honorarium directors receive for attending meetings is clearly out of proportion to the heavy financial responsibility which law imposes upon them."

That is one important phase of it. Another aspect of the problem was vividly described to me the other day by a prominent investment banker. He was recounting on the basis of personal experiences recurrent episodes in modern corporate management where the director was nothing more nor less than a "yes man" for the person who was responsible for his being on the board. If that person was the president of the corporation, the director was always ready for a resounding vote of confidence in the president. If that person was a banker, the director had his eye perpetually cocked for such morsels at the corporate table which might interest the banker. The director was largely oblivious of any real responsiblity to the owners of the enterprise. The investment banker who recounted these episodes to me called such activity of directors abdication. I agree.

I have spoken of inactive directors, and I have used the term in rather a critical way. It may be only fair to the inactive director, however, to point out that perhaps the corporation should not expect to get more than it pays for, and that it pays its directors a very small "honorarium" indeed. Yet that is small comfort to the stockholder. But in final analysis, if directors are to perform their duties honestly, efficiently and constructively they should get paid for their work, in proportion to the actual contributions made by them. When the corporations so often attempt to get something for nothing, it is no wonder that the directors are sometimes tempted to collect invisible rewards, to make use of their inside information, their market tips, their banking connections, and otherwise to serve themselves rather than their stockholders. Such a tendency is destructive of the spirit in which a position on a directorate should be accepted, for it puts the opportunities of the office far ahead of the responsibilities. Yet it is difficult for some directors to maintain a professional attitude toward a job which is not set up on a professional plane.

Furthermore, even the most ethical, the most capable director cannot do justice to the position in the amount of time he has to give it. He may not spend more than twelve or fifteen hours a year at Board meetings, and between meetings he may never give his directorial duties a thought. Napoleon was a great general, but he did not try to practice his trade on a schedule of one day a month.

So much for the handicaps under which the director labors; now let us look at some of their unfortunate results. In speaking of directors, I have thus far been speaking of directors who are not officers of the companies on whose boards they serve. They are "outside" directors, in the sense of not being members of the executive group which constitutes the management of the concern. But of course the officers of the corporation also are represented on its Board. The president is always a director, and so may be any number of his major executives. One large corporation, for instance, has fifteen vice presidents, all of whom are directors as well and who together make up a majority of the directorate. Thus Boards of Directors are made up of two kinds of directors: the "outside" directors, who theoretically guide and control the management and the "inside" directors who are the management itself. Because the "outside" directors spend so little time with the company and because their knowledge of affairs is so superficial, they tend to take the management's word for everything that comes up, if the management is strong.

In addition, there is frequently on the board a "strong man" or a not-so-strong man representing a great bank, an important company or a single security holder (perhaps an insurance company). He may or may not be an officer of the company. But because of the powerful interest for which he speaks he can and does dominate his fellow directors, who, for the most part, have little or no stake in the enterprise and may derive little benefit from their positions. He speaks with the authority which is a product of vast accumulations of wealth and influence.

As against the informed management directors or the powerful representatives of important interest, the remaining directors are powerless. They have not the knowledge or information necessary to appraise, check and evaluate proposals made concerning the conduct of the company's affairs; and they have not the specific knowledge and information, nor the economic interest necessary to resist the policies and program of powerful interests. Indeed, so long as a man is a director of a company merely as an avocation - devoting no substantial part of his time to its affairs and deriving no income from it - we can hardly expect that he will be very wise or aggressive in opposing the program of those who seem to speak with knowledge; or that he will jeopardize his own economic interests by opposing the wishes of influential groups.

This tendency to follow the leader violates the traditional idea of what a Board of Directors should be. When the ordinary citizen, or the ordinary stockholder, thinks of a director, he thinks of the independent director. He thinks of the Board of Directors as distinct from and superior to the management. He thinks of the directors as men whose advice the management will seek and who will exercise independent judgment on corporate problems. But this kind of director is too often nothing more than a myth.

What we frequently have today is a large majority of directors who are dominated by a few management men or men representing special interests. These directors have abdicated. It is not enough to describe them as directors who do not direct. Too often they do not even influence. They have become little more than ratifiers. They ratify decisions which they have not reached, based on arguments and evidence which they cannot appraise. What was designed as a position of great responsibility is in danger of degenerating into a position of mere routine. The average modern director does not direct the course of the corporation to a much greater extent than a conductor directs the course of his trolley-car. Both of them go along with the vehicle; and one of them is often present only for the sake of the ride.

The decline of the power of these directors has seriously menaced the position of the stockholder - particularly of the small stockholder who is found in such great numbers on the books of the larger corporations of today. The position of the director has in it a large element of trusteeship. It is to him that the stockholder looks for the protection of his interests, for the safety of his investment. And when he abdicates his position, the stockholder has no one to whom he may turn. Since the beginning of corporate history - and particularly since corporations began to turn to the public for their funds - it has been recognized that the interests of stockholders could not be adequately served by managements alone. Managements, occupied with day-to-day problems and subjected to day-to-day pressures, cannot provide the necessary dispassionate, long-term guidance. The check of a board of vigilant, well-informed directors is needed to assure that management is always loyal, honest and prudent.

Neither has the stockholder - except the occasional very large stockholder - the slightest possibility of representing himself. There are corporations with thousands, tens of thousands, even hundreds of thousands of stockholders, each with a very small interest in the concern. We all know that a man with ten shares is not an influence in a big company. We all should know that ten thousand men with ten shares each are not an influence either. For no matter how many shares the small stockholders may hold as a group, their voice in the company is as small as their microscopic holdings as individuals. They have no way of acting together, and so their votes are counted apart. This situation is a commonplace of corporate history, but it is a dangerous commonplace none the less.

So we have a situation in which a very large numerical majority of stockholders in American corporations has a dangerously inadequate representation on their corporate boards. We have ownership without authority and we have authority without ownership and, which is worse, without responsibility.

The attitude of the "insider" toward the "outsider" is well illustrated by the remark of a prominent investment banker who was on several directorates during the worst years of the depression. Conditions were so bad that even the stockholders were making themselves heard, although they were rarely successful in making themselves felt.

"I went to the perfect stockholders' meeting the other day," said the banker.

"How was that?" asked a colleague.

"Well," said the banker, "It was this way. None of the stockholders came."

The failure of so many directorates to live up to the responsibilities of their position, and the consequent peril to the small stockholders who constitute the great bulk of investors in American business, demonstrate the need for a change in the directing personnel.

In Great Britain, progress has already been made along the lines that we are now discussing. In the conversation I had the other day with Joseph P. Kennedy, he told me:

"In England directors are sometimes chosen for their prestige, but more often they are elected for their special knowledge of the business. Directors are expected to take and actually do take an active part in supervising corporate affairs. The result is on the whole that the British enjoy a higher standard of directorate responsibility than obtains in this country. Moreover, usually the membership on a board is small with the result that it is seldom found that directors serve on more than a few boards. The English, with a sense of reality, compensate their directors for the time and effort they are required to devote, and do actually devote, to an enterprise. In line with the duties they assume, their compensation is fairly substantial. We (in this country) must find a way to restore in practice what has always been our theory -- the principle that a director is a fiduciary owing obligations to the stockholders to protect them in supervising the management."

According to Mr. Kennedy's statement (and few men are better qualified than he to report on directorates) the British have taken steps to change their directorates so as to make them less ornamental and more useful. It should not be difficult to take similar steps in this country. Corporations can and should take steps to place upon their boards working directors who are adequately compensated; and the responsibilities of these directors should be made commensurate with their trust.

Furthermore, we should have smaller directorates. It is in the unwieldy boards of the larger companies that inactive directors are most numerous. In discussing this phase of the problem with me, Joseph P. Kennedy said:

"Nothing more clearly reveals the extent to which American business practice deviates from corporate theory than the Directory of Directors. That volume discloses the American phenomenon of multiple directorships carried to ridiculous lengths. Not very long ago a prominent financier was shown to have had over 50 directorships. Assuming even the most highly developed financial genius, it is still true that this man was incapable of rendering to his companies even a small fraction of the necessary supervision service. I believe that in most cases a limited number of directors on a board would be desirable. Where a large directorate is deemed advisable because of the size of the company the executive committee should be on a full time basis or nearly so. If wisely chosen and adequately compensated such a committee would enable the board of directors to provide effective supervision over the affairs of even the larger industrial enterprises."

I agree with him. Corporations under their own motive power can reform their system of multiple directorships so that no man can sit on fifteen, forty or even fifty boards. A man who belongs on fifty boards obviously can work on none.

Particularly significant are Mr. Kennedy's references to the time and effort that English directors "actually do devote" to their enterprises and to the fact that they are compensated "in line with their duties." For here the English have apparently gone far towards realization of the idea that I wish to present to you today. That is the idea of the paid director -- the professional director to take the place of the inactive director who does so little in the way of actually directing or supervising corporate managements. The paid director, familiar with the affairs of his company, could not live in peaceful and happy ignorance, oblivious to the fact that warehouses and inventories which his company owns are figments of a criminal imagination.

The term "paid director" may come as a novelty, but there is really nothing startling about the idea. Perhaps we might put it better by saying that we need more efficient directors and we can get them only by putting the position on a salaried basis. The paid director would have no business interest other than serving on the Boards of a few corporations. He would acquire a thorough knowledge of these corporations, and he would sit as a representative of the public interest - particularly of the investing public which owns such a large part of our corporations and has so little influence in them. He would, of course, be elected by the stockholders. And his influence would, I believe, be immeasurable. Salaried, professional experts would bring a new responsibility and authority to directorates and a new safety to stockholders. The interests of the general public would also be more carefully considered than they frequently are today.

With no conflicting interests whatsoever, the paid director could give his full attention to his company's affairs. He could visit the factories and the warehouses. He could know if the plant was being carried at too high a value; he could look not merely at statements of inventory but at the inventory itself. He would be able to penetrate the mysteries of the balance sheet and see the realities that lie behind it. He would not be merely a director at Board Meetings, he would be a director between Board Meetings as well. He could give the directing job more time in a week than many a director gives it in a year.

Furthermore, the paid director would revive and strengthen the tradition of trusteeship. His job would not be to represent the management or to represent himself. It would be primarily to represent the stockholder - to return to the stockholder the protection which today's stockholder has too frequently lost. In a larger sense, he would not be so much a paid director or a professional director as a *public* director, representing not only the present but the potential stockholder, and representing the general public as well.

Today it is generally recognized that all corporations possess an element of public interest. A corporation director must think, not only of the stockholder but also of the laborer, the supplier, the purchaser and the ultimate consumer. Our economy is but a chain which can be no stronger than any one of its links. We all stand together or fall together in our highly industrialized society of today. One function of the paid director would be to harmonize those various elements so far as possible. For although those elements may superficially appear to conflict, the fundamental interests of all social groups are identical over the long term. The corporate officer frequently recognizes these principles; but he is so close to his work that it is hard for him to look beyond its immediate necessities. But the paid director need not be afflicted with such nearsightedness. It would indeed be one of the defects which he would be paid *not* to have.

The problem of working out the paid director plan would of course present many details. But I feel that the principle is sound. There would be no lack of capable, mature, experienced men to enter the new profession of full-time director. There are any number of men whose successful business or banking experience has qualified them to act in an advisory capacity. It is one of the major deficiencies of our business system that we throw away so many matured intellects, so much wise counsel. In the paid directorship we would open up a new profession, a profession which would tap a tremendous reservoir of experience and wisdom, much of which finds no adequate outlet today.

We are a capitalistic economy, and only so long as we remain a capitalistic economy will we remain a democracy. Capitalism and Democracy are Siamese twins; they cannot live if separated. The most serious body blows to capitalism do not, as some would have us think, come in the form of legislation. They come in scandalous mismanagement and reckless disregard of the ancient principles of trusteeship. Episodes of the type which have been currently in the public eye dissipate the confidence of the investors and thus weaken Capitalism. Confidence is the bulwark of Capitalism as it is of Democracy. We should take such steps as are reasonable and practicable to perfect the corporate mechanism so that investors will be safeguarded (actually as well as ostensibly) against at least the more flagrant type of management abuses. And I feel strongly that this should be preeminently a job for business and industry. Continuous alertness by an agency like the S.E.C. can go far towards prevention. You can count on us for constant vigilance. But our powers quite properly fall far short of supervision of management and within its limited powers any agency like the S.E.C. can seldom be more than a policeman. An effective job requires a leadership by business and an alertness of industry to its own responsibilities. Industry has it in its power to take the lead by putting its whole corporate house in order. Every such chore should not be left to government. Let us not look to government for leadership except where self help breaks down.

I believe that we are on the eve of a real resurgence in our economic life, a resurgence in which changes in our corporate directorates will be an important and an inspiring factor. Some such changes I consider inevitable, because it will be very difficult in the future to find men of responsibility who, without adequate compensation, will assume the real duties and the real responsibilities which should go with the directorships of today.

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