

The Leadership Challenge for Directors
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I want to thank you for your invitation to participate on this panel today. I am especially pleased to have the chance to discuss “The Leadership Challenge for Directors” because governance in the Farm Credit System is an issue that is very important to me. Since becoming a member of the Farm Credit Administration Board five and a half months ago, I’ve had the chance to visit with a number of Farm Credit institution boards. In each visit, governance was at the top of my list of issues to discuss with them.

One of my greatest concerns is how the evolution and complexity of the System is resulting in more and greater demands on directors. These demands require that they be more knowledgeable about the business of directing a System institution, because the business is getting more difficult to understand with more complex products.

Also, I firmly believe that with continued consolidation within the System, and with your managers becoming more market driven, the challenge of board governance will be even greater in the future. Therefore, I think it is essential that we have effective leaders and policy makers to direct the System’s future development and success.

This makes it especially important that you have a nominating committee that recognizes its tremendous responsibility to not only identify but also recruit highly qualified candidates to stand for election to the board of directors. Excellent board governance begins with the nominating committee. Nominating committees need to tap all of the resources they can in identifying and recruiting board candidates. I encourage you to review FCA Bookletter 043 to guide you as directors in providing appropriate assistance to nominating committees. You should also review your policies and procedures on the nominating committee process and consider broadening, to the extent permissible, the activities employees and agents may engage in to help the nominating committee fulfill its responsibilities.

You, as board members, may also be involved in the nomination process, including the following activities:

- Invite the nominating committee to attend a board meeting so that they can gain a clearer understanding of the role of the board. You can also discuss your views on the functions of the board and needed skills and expertise.
- Attend local gatherings to promote the benefits and rewards of board service and encourage voting stockholders to make themselves available as potential candidates.
- Meet with the nominating committee to discuss potential candidates. Just be sure that no board members are present when the committee deliberates and votes on its slate of candidates.

While these activities by the association's board and employees are permissible, I want to emphasize the importance of independence in the nominating committee process. In fact, it is critical to the success of the association. There must be independence to assure that the voting stockholders, not the current board members or association management, choose the slate of candidates.

One mistake that nominating committees need to be careful not to make is treating the nomination process like a popularity contest. That is not the appropriate role of the nominating committee. Also, the nominating committee should not be looking to reward someone for their long-time or successful farming operation. Keep in mind—just because they are a good farmer does not necessarily mean they would be a good board member.

It is very important that directors have the right combination of knowledge and skill sets to do the best job they can in serving on the board. This is becoming even more important as the size and complexity of associations increase. I believe this makes it especially important that new board members have good business and financial skills.

In the past, I think there was a tendency to believe that board members did not need good business and financial skills, and that they could pick up what they needed after coming on the board. That is no longer the case. The growing size and complexity of today's associations, combined with the aggressive market driven managers, can quickly overwhelm a director who does not possess the background and skills needed to understand the operation and the potential impacts of their decisions on the association.

As I have been meeting with System institutions around the country, another one of my key discussion issues is diversity. Diversity includes demographics, both geographic and commodity representation. But in addition, striving for diversity should include considering different experiences, skill sets, and viewpoints. Diversity also includes considering women and minorities, not just for boards, but also for nominating committees, management and employees. I think it's better to address how to proactively address diversity now than wait for outside pressure forcing this issue on you. There is a need for good, open dialogue in the System on how to improve in this area. I would also encourage you to address diversity as a part of your strategic planning efforts.

Directors should be able to set the course for the future direction and success of the association. In addition to having the business and financial skills I discussed earlier, a highly qualified director should be able to:

- visualize what is needed for the future of the association;
- develop a strategic plan to achieve that vision;
- hire and evaluate a chief executive officer;
- develop and adopt the policies that direct and control association operations; and
- monitor the performance of the association.

These points relate closely to the points made in an October 1999 article in *Chief Executive Magazine* entitled "Boards: Going From Good to Great." The author of that article, Robert W.

Lear, suggested that there are five critical ingredients involved in the building and operating of a great board.

First, he noted it takes a competent and confident CEO who wants to have a great board. Second, he thinks it takes at least three strong and independent directors who want to belong to a great board. Third, a regular performance review program should be put in place. There should be an annual review of the performance of the CEO and the board, and of the individual directors every three years. Fourth, at the end of each quarter, there should be a review of the strategic plan, referencing those steps that were scheduled to have been done to realize the plan. And fifth, at the end of each board meeting, the directors should meet without the CEO present. This should be routine, whether there is something specific to discuss or not.

Another point I want to discuss today is the importance of having a board audit committee. To do the best job it can, a board of directors needs to have a good audit committee. A good audit committee, and especially its chairman, should thoroughly understand the financial and accounting procedures, know the IT systems, understand the ethics and compliance programs, monitor internal controls, and be able to oversee the work of the outside auditors. As a new FCA Board member, one of my goals is that the agency adopts a regulation requiring Farm Credit associations to have audit committees. Currently, the regulations only require Farm Credit Banks to have audit committees. But now, especially with the consolidation in the System, association boards also need audit committees.

I believe it is essential that great boards evaluate their skill sets, including personality traits and their overall board performance. This leads me to another point I would also like to briefly address—the outside director selection process. This also relates to what I said earlier about my concerns with the evolution and complexity of the System and the greater demands on directors.

Here again, I think it is important to seek independent outside directors with strong financial backgrounds and experience. I also strongly encourage having more than one outside director. This would help the association strengthen and diversify its directorate and add special areas of expertise, which may not be present among existing members.

I'm not saying each board should have three outside directors, as suggested in the Chief Executive article I referred to earlier. But I am saying that seeking skill sets that complement elected board members will help associations successfully face the growing challenges of providing appropriate governance in the future.

I want to thank you again for inviting me to serve on this very important panel today. I'm looking forward to working with you during my term on the FCA Board.