



Three Key Roles of the Board of Directors

Understanding the three key roles of the board of directors can help shape the board's agenda, establish information priorities, and support trust and transparency in the board-management relationship.

Contributors

Holly J. Gregory
Partner at Sidley Austin LLP

Summary

- Boards must distinguish between offering perspective and taking back delegated authority
- Boards must carefully consider what authority to delegate to management and what to reserve for directors
- Boards should evaluate whether they are appropriately structured for risk and compliance oversight

In reaction to ever-increasing business complexity and governance expectations, directors may be tempted to weigh in at a deeper level of detail on a broader range of issues affecting a company. Maintaining clarity about the board's role can help the board set priorities and determine whether and when to dive deeper.

As the highest authority in the company, the board plays three key roles. The board acts as:

- A decision-maker, responsible for making certain decisions including, but not limited to, how much authority to delegate to management, board committees, and others.
- An overseer of the authority it has delegated.
- A "sounding board" for management, when management would like input on matters within management's delegated authority.

Understanding these three distinct roles can help set the board's agenda and information priorities. It can also help support an appropriate relationship of respect and trust among directors and between the board and management.

This article discusses board authority and delegation generally, expands on the three key board roles, and highlights best practices for an effective board-management relationship.

Board Authority and Delegation

State corporation law typically provides that the board is responsible for the management and direction of the corporation. For example, Section 141(a) of the Delaware General Corporation Law (DGCL) provides that “[t]he business and affairs of every corporation ... shall be managed by or under the direction of a board of directors.” This gives the board broad discretion to delegate management activities to others, subject to certain limitations where the statute requires a final decision to be made by the board.

While the board has clear authority under state law to manage the business, in a company of significant size and complexity, and certainly for publicly traded companies, the company’s day-to-day affairs are typically delegated to a professional team of managers led by the CEO. In addition to putting management into the hands of professionals who are employed on a full-time basis to run the company, this also positions the board to serve as an accountability mechanism distinct from the senior management team. In publicly traded companies, this separation, combined with a board composition dominated by independent directors, allows the board to provide objective monitoring of management’s performance.

While boards have wide discretion (within certain limits) to determine how much authority to delegate to management, determining what to delegate and what to reserve for the board requires careful consideration. Full-time senior management will always have more information about and insight into the business and operations of the company than outside and independent board members. For this reason, in addition to authority for day-to-day operations, management is typically delegated authority to execute and implement strategic and business plans and to make certain non-strategic decisions. Additionally, while the board to varying degrees based on the materiality of an issue may retain final approval, the CEO and

senior management typically propose and drive discussions on:

- Strategic planning and creative initiatives.
- Financial goals.
- Capital and resource allocation.
- Risk appetite.
- Talent development.
- Corporate policies.

This reflects the principle that “[e]ffective directors are diligent monitors, but not managers, of business operations. They exercise vigorous and diligent oversight of a company’s affairs, including key areas such as strategy and risk, but they do not manage — or micromanage — the company’s business by performing or duplicating the tasks of the CEO and senior management team.” (Business Roundtable, [Principles of Corporate Governance](#) (2016).)

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When allocating authority between management and the board, the board should consider:

- Whether directors have the time, information, expertise, and understanding of the business and the industry such that the board’s involvement is likely to improve the quality of management’s decisions.
- The potential for a negative impact on management accountability.

“To provide oversight of management and hold it accountable for performance requires that the board function as a body distinct from management, capable of objective judgment regarding management’s performance. ... Undue board involvement in matters of management may impair the board’s ability to provide objective oversight of management performance.” (National

Association of Corporate Directors, *The Future of the American Board Report: A Framework for Governing into the Future* (2022) (membership required) (NACD Future of the American Board Report).) When the board makes management-level decision, the board's ability to hold management accountable for outcomes is lessened. Moreover, micro-managing by the board may condition management to await board guidance, and frequent board intervention and second-guessing may cause managers to become risk averse.

In making decisions and overseeing delegated authority, directors should be aware of available protections to minimize liability. One of the most potent director protections is the exculpatory charter provision authorized by DGCL Section 102(b)(7), which immunizes directors against monetary damages for breach of the duty of care. (Companies should note that in August 2022, the Delaware statute was amended to allow Delaware corporations to expand such protections to certain corporate officers (with the exception that claims against officers will not be barred "in any action by or in the right of the corporation").)

Another protective statutory provision for directors is DGCL Section 141(e), which states that "a member of the board ... shall ... be fully protected in relying in good faith upon the records of the corporation and upon such ... reports ... presented ... by any of the corporation's officers or employees ..." or experts. This should encourage the delegation of fact-finding and analytical work from the board to management and outside experts, bearing in mind that "good faith" oversight still requires appropriate probing of that work by the board.

(For model documents for delegating authority and model board resolutions approving these documents, with explanatory notes and drafting tips, see *Signature Authorization and Delegation of Authority Policy*, *Delegated Authorities Table*, *Delegation of Authority Form*, and *Board Resolutions: Approving a Signature Authorization and Delegation of Authority Policy* on Practical Law.)

The Board's Decision-Making Role

A recurring corporate governance issue is where to draw the line between the role of the board and the role of the professional management team (see NACD Future of the American Board Report; Business Roundtable, *Principles of Corporate Governance* (2016)). The board's discretion to make this determination is subject to legal requirements and stock exchange listing rules, business judgment, and investor expectations. The company's bylaws may address specific responsibilities and authority and should be reviewed when considering whether to delegate or reserve authority.

Generally, the following decisions are reserved to the board:

- Amending the certificate of incorporation and bylaws.
- Issuing stock and granting equity (for example, options and warrants).
- Recommending actions to shareholders.
- Filling vacancies on the board.
- Approving a merger agreement or other material transactions, including engaging in a sale or distribution of all or substantially all of the company's assets.
- Borrowing or lending material amounts of money.
- Declaring a dividend.
- Approving the company's strategic direction.
- Adopting an annual budget.
- Appointing or terminating the CEO and other senior officers.
- Establishing board committees.
- Delegating authority to officers, board committees, and others.

- Adopting employee benefit plans (including 401(k), profit-sharing, and health insurance plans).
- Adopting significant corporate policies.
- Retaining and overseeing the independent auditor.

Delaware case law relating to change-in-control transactions supports the principle that any concrete step to explore the sale of a company should be authorized by the board. Specifically, on these matters, boards should take “an active and direct role ... from beginning to end.” (Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).) Additionally, stock exchange listing standards require that certain decisions related to the retention of the independent auditor, executive compensation, and director nomination and governance be delegated to independent directors or committees populated solely by such directors.

The Board’s Oversight Role

The board must provide oversight of matters that it delegates to management and others, and therefore a significant focus of board activity involves overseeing management’s performance. Oversight is the continual inquiry by directors into whether the board’s delegation of authority to management is reasonable, and whether the information that management provides to the board can be relied on.

Typical areas of oversight include:

- Strategic initiatives.
- Operational and financial performance (and the related integrity of financial accounting and reporting processes).
- Risk management.
- Compliance.

Oversight of strategy and risk are key areas for board focus (see NACD Future of the American Board Report). The board generally approves

corporate strategy that is proposed and developed by management with input from the board, and the board must understand the risks associated with corporate strategy and business operations. In addition to monitoring management’s performance in implementing strategy and operating the business, the board must also ensure that management has appropriate risk management and compliance systems in place along with the information and control systems that are designed to bring risk and compliance issues — especially with respect to “mission-critical” risks — to management’s and the board’s attention.

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Boards must monitor risk on an ongoing basis, and they must do so rigorously with respect to mission-critical risks. Boards need to be prepared to act on risk and compliance issues as they arise and should attend to the board’s own structure and processes for oversight of risk and compliance. The taxonomy of risk will differ for each company, but major risks in the current environment include:

- Technological and business model disruption.
- Natural disasters and pandemics.
- Geopolitical disruptions.
- Inflation (and the risk of recession).
- Access to capital and liquidity concerns.
- Supply chain issues.
- Human capital competition.
- Product safety.
- Cybersecurity and data privacy.
- ESG exposure and associated reputational harm.

A majority of public companies vest oversight responsibility for a wide range of corporate risks in their audit committees, which, as required by listing rules, are populated by individuals with financial literacy, but who may or may not have experience with the material non-financial risks facing the company. Freestanding risk and legal/compliance committees remain relatively uncommon, as are committees focused on the environment, health, and safety. According to the 2023 Spencer Stuart Board Index survey of S&P 500 companies, 12% of S&P 500 boards have a risk committee, 6% have a legal/compliance committee, and 13% have an environment, health, and safety committee.

Boards should periodically evaluate whether they are appropriately structured for oversight of the critical risk and compliance issues that are most relevant to the company (including whether the board has appropriate composition relevant to mission-critical risk oversight), and should also periodically review the information and control systems that are designed to ensure that relevant information is brought to the attention of management and the board in a timely manner.

(See NACD Future of the American Board Report; for more information, see [Future-Proofing the Board of Directors](#) in the May 2023 issue of Practical Law The Journal and see [Board Oversight of Compliance](#) and [Board Oversight: Key Focus Areas for 2022](#) on Practical Law.)

The Board's Sounding Board Role

An effective board is comprised of members with significant experience, skills, and expertise relevant to the company's business. This collective experience and expertise makes the board a valuable resource for management. However, it is management's prerogative whether to seek board perspective on matters within management's authority. When the relationship between the board and management is one of mutual trust, respect, and candor, management is more likely to

seek board input on important matters. For management to fully use the board as a forum for testing ideas and seeking guidance, management must have confidence that the board or individual directors will not use the opportunity to overstep and micro-manage by giving direction on matters that are for management to decide.

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When management consults with the board, the board in turn benefits from the enhanced transparency into management's decision-making processes and earlier involvement in matters that may ultimately require board oversight or even board decision-making. As a practical matter, this sounding board role is often intertwined with the board's oversight role because exposure to how management is thinking about and approaching an issue provides a basis for the board's judgments about management performance and capability. It is important for boards to avoid viewing a sounding board opportunity as a request to take back delegated authority. To avoid confusion, management should clearly indicate when it is bringing an issue forward to obtain the wise and experienced perspective of directors to assist management in its own consideration of the matter.

Practical Guidance

To create a successful dynamic between the board and management and leverage the strengths of both teams, companies should:

- **Adopt a collaborative mindset.** Highly effective boards and management teams collaborate on important matters. For example, while management proposes and develops strategy, it is common for there to be an iterative process between the board and management when significant strategic change is being contemplated. A collaborative mindset helps

support a culture of transparency while ensuring that the board and management remain aligned on the company's vision. (For more information, see [Establishing Norms for Director Behavior](#) in the Fall 2022 issue of Practical Law The Journal.)

- **Regularly assess the board's approach to delegated authority.** The board should periodically review where board and management authority have been set and, in particular, what matters are to be brought to the board for decision and what information is presented to the board for oversight. These discussions can be held in the context of regular education about fiduciary obligations and effective governance practices (for more information, see [Fiduciary Duties of the Board of Directors](#) on Practical Law). The post-annual shareholder meeting period may be a logical time to have these discussions, which may be particularly helpful in orienting new public company directors and activist directors joining the board on how the board has defined board and management roles. The board's formal delegation of authority (or reservation of authority) should be reviewed every several years to ensure that it is clear and remains appropriate. Periodically, the annual board self-evaluation process should inquire into director (and management) views on whether the line between the board's role and management's role has been clearly and appropriately set, and whether directors and management understand and are respecting the agreed delineation.
- **Set expectations, including that the board focus and approach may change with the circumstances.** The board should set clear expectations with management of when the board should be informed of company developments in real time and when the board may want to become more deeply involved. Board activity is context dependent, and increased levels of board involvement in

decisions and oversight may be appropriate, for example, if:

- a crisis arises;
 - the business needs to pivot in a new strategic direction;
 - there has been a period of unresolved underperformance;
 - confidence in the CEO has waned; or
 - there are other material unresolved issues affecting the company that call for a higher level of board attention.
- **Insist on discipline in setting board meeting agendas and information priorities.** Meeting agendas and related information provided to the board should align with board priorities and roles. While priorities will vary from board to board, it is likely that they will involve issues of strategy, risk, and both corporate and CEO performance. The board should expect, and the corporate secretary should ensure, that matters on the board agenda and items provided to the board include an indication of the purpose for which they are included, whether for decision, oversight (and background), or to seek director viewpoints as input for a management decision. This same discipline should also be used by directors when requesting that an item be added to the agenda or when requesting information.

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