Graziadio Business Report
A Journal of Relevant Information and Analysis

2008, Volume 11, Issue 4

Corporate Governance, SOX, and the Business Judgment Rule

Audio interview with CEO Coach John Rehfeld

Danielle L. Scott

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Start

Danielle L. Scott: Good day. This is Danielle Scott, associate editor of the *Graziadio Business Report*, the online business journal of the Graziadio School of Business and Management of Pepperdine University. Today we are interviewing John Rehfeld on the topic of corporate governance. John is a seasoned marketing driven CEO with 30 years of software, content and hardware experience is the PC, digital imaging and multimedia industries. He has a strong track record of commercializing technical innovations through third-party distribution channels into the business and consumer markets. He also has significant international strategic relationship experience with Asian companies, especially at the senior executive level, and he has been a Federal Trace Commission monitor, overseeing and reporting on the sale of a software division to EDS. In 1988, he was named one of the top 25 computer industry executives by *Computer Reseller News*. Mr. Rehfeld is currently working as a CEO coach for six CEOs in California and is serving as an outside board of director member for three public companies and three private companies. He is the chairman of the Forum for Corporate Directors in Orange County, an adjust professor of marketing and strategy for the executive MBA at the Graziadio School, and a member of the GBR editorial review board. John Rehfeld has published several articles about the role of the board in

CEO transition and in company strategy. In 1994, he authored *Alchemy of a Leader*, which compared Japanese and Western management styles, and was published by John Wiley and Sons. Mr. Rehfeld received a Bachelor of Science in chemical engineering from the University of Minnesota. He completed his master's in business administration at Harvard University. John, thank you so much for being here with us today and agreeing to share your considerable experience as a CEO, chairman, and board of director member with us.

John Rehfeld: You're welcome. I'm pleased to be here. Pepperdine is a great institution, and I'll do everything I can to help Pepperdine and, most importance, Pepperdine customers, which are students, and listeners.

Danielle L. Scott: Well, you are certainly helping us out today. So I wanted to start off with, in general, the role of the board of directors of a company is to create and protect shareholder value. But as an outside board of directors member for three public companies and three private companies, what are your duties?

John Rehfeld: Very simplistically, the role of the board is to be the steward of the shareholders' interest in oversighting management. So in the case of a public company, the shareholders are figuratively thousands and thousands of widows and children. Basically large shareholder interests are not sitting on the board, nor are they really sitting with the management team. So that kind of stewardship, you really are representing this vast number of shareholders that have nobody to represent them or look out for them except for the board. An outside board member, often called independent board member, is somebody's who's generally not a member of management, or not a major shareholder. I just want to take a moment to contrast that to a private company. In the case of a private company, often major shareholders are either members of management and/or are sitting on the board. For example, I'm on the board of a VCBA [ph?] company, and probably 90 percent of the shareholder count is represented by the board or by the CEO. So it's a different kind of dynamic. We're stewards of the shareholders' interest, but in effect, the board is the shareholders. So it still has things to do, but it's a different dynamic.

Danielle L. Scott: So as an outside board of directors member for the private company, you still don't have any shares in the company or are not in any way connected to the management?

John Rehfeld: Correct. But I would say on a private company, often most of the board members are insiders. They're there representing their own shareholder interest.

Danielle L. Scott: Can you take us the various positions the board members can hold and their responsibilities to the corporation?

John Rehfeld: Yes, I'll be glad to. And I just want to elaborate on this outside board member concept, or independent board member. A big part of the Sarbanes-Oxley-- which I know we'll talk about later-- legislation is, on a public company, most of the key board members need to be independent. So you'll see many more independent board members on a public company, again, being stewards for this sort of number of widows and children out there. So let's talk about the various positions. Well, a big part of what a board does is oversight the compensation of the management, because if you don't have a board oversighting the management, they'll pay themselves whatever they want to, or whatever they think the company can afford. So the compensation is a very important role. So you have a compensation committee. With Sarbanes-Oxley, which, by the way, has to be all independent board members. So management can not sit on the compensation committee and oversight their our compensation. We had an audit committee, and the audit committee's purpose is to oversight and sort of validate the financial reporting. And part of the problem we had with Enron and with MCI is they were cooking the books so that they could make the performance of the company look better than it really was. So now you have to have independent board members solely make up the audit committee. The audit committee is usually three or four of the board members. You have the independent auditing firm. They're auditing the books. They report to the compensation committee. They used to report to the CFO. So you see they're taking that one step away from management. And also the auditors, the independent auditors, have to change auditing partners I believe it's every five years. But they can't get too-- there are some checks and balances to keep the auditing firm from getting too cozy with management. And also the auditing firm can only do auditing and tax. They can't do a whole host of other consulting jobs. And the anecdote at Enron is Arthur Anderson was doing all sorts of other work. So here's the poor auditing partner. If he sort of blew the whistle on the stuff, he'd jeopardize all this other work. I'm not saying that was his motivation, but it could have been. So we have compensation and auditing, and those are a must on every public board. Often on private boards, the whole board does those same functions. Then we'll often have a committee called the governance committee, which sort of oversights the processes of the board, oversights the board evaluations, the CEO evaluation. The nominating committee, which is often the same as the governance committee, is responsible for selecting new board members, and responsible for the composition of the board. All companies have those two committees. About 50 percent of the companies have a governance-slash-nominating. And then the other committee you sometimes see is a strategic review committee. If you have a large board and a large company, they'll look into more detail and oversight the strategy of the company. So there you have the committees. There's one more thing that we need to talk about, and that's the leadership of the board. We often hear about the chairman. Well, the board needs a leader. About half the time, that leader is also the CEO. So the CEO and the chairman are the same person. But we're seeing much more of a trend where we have the board members elect an independent lead director, and he is the leader of the board. I believe you have a question a little bit later on to talk more about that.

Danielle L. Scott: Right, yes. We will certainly get to that. You have also talked about advisory boards. What are these advisory boards? Why do they exist, and who makes them up?

John Rehfeld: What we often see advisory boards are new startups. It's a new startup; they don't have a lot of-- it's self-financed, or financed with some individuals. So they don't have a lot of these oversight, stewardship issues that we've talked about. But the CEO, who is often a first-time CEO, would like to get a group of sort of experienced people that have more scars on their back than he or she has. So he or she will form an advisory board. It's not an oversight board. They're not stewarding the shareholders' money. They're more advising the CEO and the management team. They may have industry or product expertise. They may be the CEO coach. Their responsibilities are different. Their liability is much less, zero basically. So they're often compensated different. But it's a good start. If the CEO starts a company, he doesn't have a lot of money, he can form two or three advisory boards. It gives he or she a little bit of cachet, that he or she has some senior advisors.

Danielle L. Scott: You said that one of the roles of the corporate board is to evaluate CEO effectiveness. What do these evaluations involve? Professors, you work with a lot of CEOs, so how do you coach them in meeting the criteria of these evaluations?

John Rehfeld: I'm going to address most of my answer to the CEO evaluations. I will say, anecdotally, I was a CEO of maybe four different companies up until Sarbanes-Oxley, up until the popularity of 360 CEO reviews. I never received a single review, because it's a little bit difficult if one person sits down and reviews you. It's sort of this value judgment. Person A is reviewing Person B. Person A is giving a value judgment on Person B. This stuff needs to be done, but personally, dynamically, it's not easy. So 360 reviews have become very popular and very effective. So what we do on all the boards that I'm on is we will have-- we'll put together a fairly simple questionnaire, maybe 10 criteria, and put a numeric evaluation down, put some comments down. We'll have the board fill that out. We may have the senior management fill that out. We'll compile them. We'll keep the numbers and the comments pretty much autonomous. The board will discuss that, and then the board or the lead director will present that the CEO. So now it's not A doing a value judgment on B. It's A being the messenger, Person A saying, "Okay, here's what five board members said about you. Here's what four of your direct reports said about you. Here's feedback for you." And that is very effective. We also, on the boards that I'm on, we will ask the CEO to get that feedback. There's good discussion that goes on; I would say 30-45 minutes of discussion between the CEO and either the board or the messenger. And then we ask the CEO, "Okay, the next time we're together, perhaps one quarter from now, two months from now, please digest this, and please come back and just tell us, 'Here's what I heard. Here's what I'm doing. Here's what I agree with. Here's what I disagree with.'" So it's a really thoughtful process to give the CEO some guidance. I want to say one more thing. The board is the steward of the shareholders' interest, but the board can't go run the company. So it's not the manager of the shareholders' interest, it's just steward over the

management team. Well, if the board is unhappy with the CFO, the board really can't go in and fire the CFO. The board's single leverage point is the CEO. The CEO reports to the board. The CFO reports to the CEO. So the leverage point is the CEO. So one of the most important jobs of the board is to hire, evaluate, train, and replace, if necessary, the CEO. That's their leverage point. So this evaluation and feedback and constructive criticism is super important. Having said that, I want to add one more dimension. Boards now do executive sessions, and it's a regular part of board meetings and committee meetings. And that is sessions of the board-- so every time a board meets, in addition to meeting with the management team and doing the stuff, they have a private meeting of just the independent board members, and they talk about their feelings of the company and the CEO, and what they're seeing, what they're feeling. Then that's communicated back to the CEO, usually by the lead director. So the CEO is getting this formal 360 evaluation once per year, but the CEO is also getting sort of an informal executive session feedback every board meetings. And most boards, in public companies, meet about five times a year. So five times a year, the CEO is getting this feedback, coaching, constructive criticism.

Danielle L. Scott: How do these evaluations, how do they work with the compensation of the CEO? Because there's also a compensation committee on the board. Is that part of the deciding factors in creating the executive compensation packages?

John Rehfeld: Generally, yes. The answer is yes, but also the performance of the company. Remember, we're talking to Person B, which is the CEO, he or she, and we're talking about, "Here's what we believe you're doing right. Here's what we believe you're doing wrong. Here's where you could improve." A lot of that is not financially oriented. The number performance of the company is sort of black and white up there. We know if we're achieving budget, if we're not achieving budget, if we're growing, if we're doing better than our benchmark peers, if we're not doing better than our peer companies. So those are the metrics. And I'd say a big part of how we are evaluating a CEO is based on those metrics. So to pick a number, 85 percent is based on the metrics, and 15 percent is based on our subjective evaluation of the CEO. Now, clearly, remember the metrics are not necessarily absolute how you're performing. It's how you're performing relative to a budget that you presented to the board. So the economy may be very bad and you're presenting a budget that has no growth, and if you achieve that budget, then you're doing okay. So the performance of the CEO is measured strongly against the performance to agreed upon criteria-- the budget. And then, okay, say the CEO is doing okay on that. Then how do we pay that CEO? Well, a big part of what we do, and we have to be very careful, but it's sort of the only we have, is benchmarking against CEOs in equivalent companies. I used the word "peer" companies. So in the case of-- the largest board I'm on is ADC Telecomm, which is a one and a half billion dollar telecomm hardware company. But we have about 17 peer companies that are similar size, similar industries. We know exactly what those other CEOs are compensated, because it's all published in the proxy data. We know down to his country club membership, if he or she has one, down to whatever, because the SEC require that all that compensation is very fully disclosed. So we compare and we benchmark CEO B, the person we've talked about, compared to 17 other CEOs in equivalent

companies. Now, you have to be careful, because people will often say, “Well, our CEO is better, and our CEO is the best. Therefore we need to compensate them more than these other 17 CEOs.” And believe me, a CEO doesn’t get to be a CEO without being a good negotiator. So the CEO is going to come in and say, “I’m better than those people, and I need to be paid better.” And basically you just can’t do that. You need to pay at median. Median is the same. Because if you ratchet your CEO up, and then the CEO down the street ratchets that up, you’ve just got an escalating thing. And that has happened, and you just have to be very careful. So you compare against your peer CEOs in similar size, similar industries. You also compare against the other people in the company. You don’t want a CEO making 50 times more than his next report. Something we’ve heard a lot about is the CEOs in America are making 200 times what the average worker is paid. Versus in Japan, they make 40 times that. But that’s a sociological thing, and even though I don’t like it, as chairman of the comp committee, I can’t change it. But you want to make sure there’s something that we call internal equity. So the CEO relative to his next report, relative to their next report, has some kind of internal equity.

Danielle L. Scott: And what kind of measurement do you use for that? Is it 50 times? Is it 100 times? Is there a number that you use?

John Rehfeld: Well, the average is the U.S. is 400 times. I hate to say it. The boards I’m on, they’re not making 400 times. So it would be nice if it was less than that. It would be nice. So we look at it. It’s a data point. Unfortunately, the reality is you’ve got a CEO that’s making X. Five other CEO jobs are available, paying X, and you can’t go and say, “Hey, you really need to make one-quarter X because you’re paid 400 times more than your workers, and we want you to only be paid 100 times what your workers are.” Unless he’s a very altruistic, wonderful person, he’ll say, “Thank you very much, but I’ll go talk to one of those four other jobs that are available.” So we sort of digressed into the state of the American economy here.

Danielle L. Scott: Very important topic nowadays. Well, you spoke a little bit about the companies that you have been CEO of, and there are some that you have held the dual role of CEO and chairman of; for example, Spruce Technologies and ProShot Golf. You also mentioned there’s been increasing concern regarding the need for these positions to be independent. So I wanted you to tell me about the arguments for and against the independence of these positions and what your personal opinion is.

John Rehfeld: In smaller companies, the article about having a separate chairman-- the argument against that is the board is not paid that much money and there’s a lot of work to being a chairman, and the CEO-- it’s a more fragile dynamics, and the chairman can go sideways with the CEO, and there can be-- the chairman can really want the CEO’s job. So I think there’s some stronger arguments in a smaller company for having the CEO have the chairman title, but then had a lead director. So I’m lead director on two public companies in Irvine. One has sales of about 15 million. The other has sales of about 50

million. The CEO wanted to keep the chairman title. They had the chairman title when I came in. We've allowed the CEO to keep the chairman title, and I'm the lead director. And I think it works very well. At a larger company, it's more structure to the board. You're paying the board more. Pay to board members scale very much with the size of the company. I think in larger companies, you really can separate the role. Everybody is very mature, very seasoned. The chances are the chairman really doesn't want the CEO's job, and the chairman is-- the metrics out there is about 50 percent of larger companies, the chair is an independent board member, and the CEO does not have the title. But that metric has gone from 35 percent to 50 percent in about seven years. So it's not a sweeping trend, but it is a trend. But HP-- let's look at HP. I think it's Mark Hurd that brought in the new CEO about four years ago. They made a separate chair. Those two went sideways. Patricia Dunn. Not saying good, bad, indifferent, but they started to have some conflict. The board actually ended up asking Patricia Dunn to leave, and gave the chair title back to Mark Hurd, and created the lead director. So it's not an absolute one-way street, but I'd say it's a trend, and more so in larger companies.

Danielle L. Scott: Now, in 2005, you actually wrote an article for the GBR regarding the impact of the Sarbanes-Oxley Act of 2002. You wrote that with "SOX controls now in place in most publicly-held companies, many boards of directors are shifting attention to issues that are most likely to grow revenues and profits." Can you talk to us a little bit about the most significant ways in which you feel that SOX has changed the ways boards operate, for better or for worse? You tell me.

John Rehfeld: I'm going to say-- the sound bite is it's mostly for better. I'll deal with what some people have criticized. A part of Sarbanes is what they call Section 404, and that's the company's internal controls have to be audited by the outside auditor, and the outside auditor has to say, "Your internal controls are good, and we're putting the reputation of our auditing firm on the line by saying that." That has become incredibly expensive. So for example, at ADC, I think they spent five million dollars one year, and now they're spending maybe two or three million dollars a year. So there's been some concern-- it's all good stuff-- but some concern that this sort of tax or extra cost that companies are paying is a burden that will jeopardize our global competitiveness. And there was talk about companies are going public on the AIM-- which is the stock exchange in London-- just to avoid the Sarbanes-Oxley stuff. So we have Section 404, and that's had some criticism. The SEC has backed off on that for what they call micro-cap companies, companies with a market capitalization of less than 75 million dollars. They don't have to do that. So they backed off a bit and said smaller companies that don't have a lot of resources, they don't have to do Section 404. Not let's go to the rest of Sarbanes-Oxley, which I think is very good. And by the way, 404 is good, but it's expensive. So it's just a matter of affordability and your competitiveness with the rest of your industry. But the rest of the stuff-- well, I talked about executive sessions. That's pushed by Sarbanes-Oxley. We've talked about the audit committee reporting to the-- pardon me-- the independent auditor reporting to the audit committee and not to the CFO. That's a function of Sarbanes-Oxley. We've talked about the lead director. That's really a function of Sarbanes-Oxley. The nominating committee pretty much driving new board recruitment-- Sarbanes-Oxley. So the

world has gone from-- before Sarbanes-Oxley, the CEO sort of controlled the board. He set their compensation. The auditor reported to his report. He hired the board members. It was a pretty cozy-- there was a fair amount of insiders on the board-- fairly cozy relationship between the CEO and the board. Now it's reversed. The CEO truly does report to the board, and the board has much more relative power to do their job, to be the steward of the outside owners, the shareholders, much more tools, much more power to do that job now, as a result of Sarbanes-Oxley.

Danielle L. Scott: Does that make for a more antagonistic relationship between senior management and the board?

John Rehfeld: No. If the CEO controlled the board and didn't like somebody, they could just fire him or her, bring in his golfing buddies. That was very collegial. Now, it's more of a dynamic balance between-- a healthy, conflictive-- conflict in business is good if it's healthy conflict. So I think, yeah, there's probably more conflict. For the most part, I believe it's healthy, if you have a functional board and you have a functional CEO. So the board has more power. Therefore, they have an opportunity to have more conflict. They have an opportunity to set their own comp, not be beholden to the CEO. But a good board and a good CEO, I think it's very functional. I was a Forum for Corporate Directors breakfast this morning. It was about board culture. And the question came up, "Is there a correlation between a good board and good company performance?" And the answer is, no there's not. But there's definitely a correlation between a bad board and bad company performance. So if you have a good board, it's one of the elements of company performance. The other elements are good management team. The elements of good market space, some other things. So that's for good company performance. But if you have a bad board, if you have bad dynamics between the board and the CEO, that can very well lead to bad company performance. So you want to avoid that.

Danielle L. Scott: My next question is the last one that's going to be on SOX. Basically I just wanted to know, do you believe that the act has achieved its goal, which was to restore public confidence in the nation's capital markets and strengthen corporate accounting controls.

John Rehfeld: I believe it's achieved its goals, but I was really surprised by all this subprime mortgage stuff. So there were a bunch of-- I'll use an inflammatory word, perhaps-- but a bunch of greedy bankers and greedy mortgage brokers who were really taking advantage of the situation. So the world's not perfect. In a capitalist society, people chase the dollar. There's probably going to be problems going forward. But certainly I believe this has cured a lot of ills. And I'll give another anecdote. Mike Oxley, the congressman, came and talked to the Forum for Corporate Directors a few years ago. And he said, "Well, first we had Enron and everyone put together a pretty good package. And then we had MCI, and they went ballistic, and the package sort of went off the wall." We're talking about the legislative package, and they really had to reel it back in. But they did reel it back in. Again, the 404 is something that gets

some criticism, but that's been reeled back in. So I'd say it's a very good bit of legislation. Keep in mind that's the first major legislation for board governance, board oversight since the 1930s. So it's a long time coming. It's not perfect. It's not a perfect world. We are in a capitalistic society. We are dealing with human beings, who tend to chase the dollar, sometimes in the wrong places, but I think it's doing a good job.

Danielle L. Scott: Thank you. Now I wanted to ask you a little bit more about your career path. You have an undergraduate degree in chemical engineering. So, number one, what led you to Harvard to pursue an MBA? And, number two, how did you get involved in the technology industry?

John Rehfeld: I grew up in Minnesota. My dad was a chemical engineer working at 3M. At that time, 3M was a big company. St. Paul was sort of a company town. So where did I go to school? I went to the University of Minnesota and got a chemical engineering degree. In fact, in one summer job, I worked for Dow Chemical. But I was lucky enough to sort of stumble onto IBM, and got hired by IBM when I came out. So it's just one of those things. I didn't know any better. Working for IBM and computers seemed to be better to me than working for Dow Chemical in the Midland, Michigan. So I went to IBM. I got my first job on the East Coast as an assistant engineering, so that was sort of the technical support behind the field sales force for computers. I started meeting some people from Harvard Business School who had graduated and gone to work for IBM as salespeople. So I said, "This seems to be a pretty good thing." So after three years at IBM, I went off to Harvard Business School. It's interesting, because my dad told me later, he said, "John, I thought you were crazy when you went to Harvard Business School, because you had this great job at IBM." IBM is still a very highly regarded company, but in those days, IBM was really highly regarded.

Danielle L. Scott: The be all and end all.

John Rehfeld: The be all and end all. And they had a rental base, and they were a cash machine. But in any event, it was a good move for me. So some of those things are just serendipitous. I went to work for IBM because I didn't know any better, met some people from Harvard Business School. It seemed to be a good thing to do. I will say, I believe very strongly in having a technical undergraduate, whether engineering or economics or whatever, and an MBA from any school is just a super powerful combination. So that's why I'm here, as an adjunct professor, teaching at the Pepperdine MBA program, because it's just a great thing for a person's business career. So I got into technology there. I sort of morphed from that into the PC business and rode the PC wave. And it's been a very nice career.

Danielle L. Scott: Seems so.

John Rehfeld: Yeah.

Danielle L. Scott: Well, talk about your career a little bit. Talk about some of your professional successes. What are your most proud achievements?

John Rehfeld: So after coming out of Harvard Business School, I went to work for Arthur D. Little, which at that time was a tier one consulting firm in Cambridge, Mass. Since then, they've gone out of business. I left. I don't know what happened. But then I got the job with International Data Corporation, which is a computer industry market research company, and I sort of landed in California with that. I was with them for 10 years. One of the assignments we had out here in California was we met with people from Toshiba and helped them look at the channels of distribution in the U.S. market. So I said to the people, "Oh, if you're interested in coming over here, I'd be interested in being your general manager." Well, Japanese never say yes, no, anything. But sure enough, six months later, they called me and said, "Okay, we're here. We'd like to talk with you." I'll give some advice to the listeners. So they interviewed me. They made me a job offer, but the job offer was a senior VP of sales. I don't think they had any other strong candidates, and the business school degree was very appealing to them. So I was a viable candidate, and I had a job, so I was in a position of negotiating power. So I said, "I really need to be the VP and general manager. I need to be the number one American within the division." They gritted their teeth, and whatever the Japanese say-- "Ah-so, ah-so." But they ended up a couple days later coming back and saying, "Okay, we'll do that." So the lesson is, if you have negotiating power in a job, negotiate before you take the job. Because once you're in the job, then you're sort of tossed into all the salary curves and all the other stuff. But having grown up in Minnesota, I was a good personality that fit with the Japanese. We struggled in the computer business but we ended up bringing out a disruptive technology, dot matrix printer, that went from zero to 100 million dollars in about 15 months. Then we brought out the laptop computer, which went from zero to 500 million dollars in about two years. And that was a disruptive technology. For the listeners, a disruptive technology is when you do something radically different. Not evolutionary different, but radically different. That was a great ride and a great impact. Our mission statement was "We bring the computer to the workplace, wherever the workplace is." Not the work to the computer. At that time, the laptop was 5 percent of all desktops sold. Now laptops are about 55 percent of all desktops sold. So it really has changed the way people use computers. So I'd say that was the biggest impact. It was a fun ride. I still have a lot of friends at Toshiba, a lot of friends in the industry, and here we are.

Danielle L. Scott: Alternatively, would you like to tell us about some of the mistakes you've made along the way? I'm just figuring you made at least one, right?

John Rehfeld: But we only have an hour to talk. The biggest mistake I made is I came into a company and I was CEO. It was a couple jobs after Toshiba. I'm a sales and marketing CEO, and I really have

good instincts in sales and marketing, and I don't have that good of instincts in operations. Maybe I'm too ADD for operations. There's probably a different gene pool between strategy and sales and marketing and grind-it-out operations. So here was a company, 150 million dollar manufacturing company. We were in the desktop projector business, so we were in the computer business. I had a CEO who just didn't have that skill set. He more had the skill set that I had. So we had a big void in operations. And I think two lessons from that. One is, know your strengths and weaknesses, and if you find somebody-- understand your weaknesses. Weaknesses that you understand are okay. Weaknesses that are a blindside are not okay. Understand your weaknesses and find a way to complement those. And I didn't. I didn't really understand my weaknesses and I certainly didn't complement them. And then the second part, the COO-- I came in as CEO and the COO was already there-- wasn't the right person for the job, and some of my advisors told me that, but I just dragged my feet on replacing that person. So if you come to the conclusion that you need to move somebody out of a job, either fire them or put them somewhere else, move quickly on it, because when you first figure it out, it's their problem, and if you don't do anything about it, it's your problem. So I've never met anybody in business who said, "I wish I had replaced that person later." It's always, "I wish I had replaced that person sooner." So understand your own weaknesses, find a way to complement them, and then if there's people who need to be replaced, do it sooner rather than later.

Danielle L. Scott: I think that's a really great piece of advice. So I have some more advice questions to ask you. How has the current volatility in the U.S. stock and the overall economic downturn affected the advice that you give to CEOs that you coach, as well as your students in the executive MBA program?

John Rehfeld: I'm going to answer that slightly differently, and then if you're satisfied great, and if not, ask me again. I'm going to talk about-- the CEOs I coach, just sort of the way it's happened is they're first-time CEOs of small companies. So they're all interested in getting financing. And there's sort of two stages of financing-- well, three. The first one is you finance by selling your car, taking a second mortgage on your house, borrowing against your credit cards, and then you sort of evolve into-- I'm being somewhat facetious, but it's sort of self-financed-- and then you evolve into friends and family. But it's individual angels. Individuals. But then you get to the point, hopefully you get some traction, you get some sales, you get some product, you get some customers, and you can bring in what you call institutional money. That's commonly called VCs-- venture capitalists. Well, a venture capitalist market, they were red hot of course five years ago. But their business model is they take money from investors, and then they invest the money in startups, and they get an exit, and then they repay their investors, and then they keep part of the profit. So any opportunity they look at, they say, "How fast can I get an exit?" That's what they need to do because that's how their business model works. I mentioned I was at a Forum for Corporate Directors meeting this morning, and I ran into a venture capitalist who I've known, and I said, "Give me some metrics on this." So he said one exit is merger and acquisition. You can get this company to a certain stage and then you can sell them to another company. He said historically, startups-- startups meaning they were far enough along that they get institutional investors. So they may

not have been a pure startup, but first time they brought in institutional investors. It was three and a half years from the time they brought in preferred stock money from an institutional investor 'til the time they had an M&A. Now it's seven years. So that's double. But remember, these people want to get their money back fast. And then the other exit is an IPO; you go public. He said historically it's been four years; now it's eight years. So it's doubled. Well, venture capitalists are measured on their IRR-- their internal rate of return. So if you stretch out this time by two, their internal rate of return, roughly speaking, goes down by half. So the VC market is-- there's a lot of money out there. So I'm not saying it's drying up, but it's getting to be harder. The VC model is tougher, which means in the long run, it's going to be harder to get VC kind of financing. So that's sort of my answer to what's the volatility of the stock markets. You've heard the numbers. You've heard the metrics.

Danielle L. Scott: Yes. And they're pretty depressing. What advice would you give to those interested in serving on corporate boards and positions as lead director or other positions on the board, public or private?

John Rehfeld: I think it's a great thing. The profile of board members are sitting CEOs, and that's gone down, because sitting CEOs have more pressure to run their own company and not be sitting on a bunch of boards. The average sitting CEO serves on less than one board, where it used to be they served on more than two boards. So if you're a sitting CEO, fine, you have some opportunities. If you're a retired CEO, those have gone up. People love retired CEOs, because they have all the scars on their back, they've made all of these mistakes...

Danielle L. Scott: And they have the time.

John Rehfeld: And they have the time. And then another one is C-level executives. If you can't get a retired CEO, you can get somebody who's almost a retired CEO, C-level executive, or CFOs. So those are the kind of people that go on boards. Those are the kind of people that are desirable for boards. I think it's a great job. Shareholders need stewards of their interests. Thanks to Sarbanes-Oxley and other regulations that sort of followed in the wake of Sarbanes-Oxley, the boards have a lot of power. In public companies, the compensation for boards has gone up about 30 percent in the last two or three years. You're not doing it for the money; you're doing it because you can help the company; you can sort of work with other people that you like. But, the money's nice. So I'd say it's an important-- and you don't know how many-- since I'm sort of a high-profile chairman of the Forum for Corporate Directors, people are coming to me all the time. "I want to join. I'm in the _______________ of my career." They're one of the people I mentioned. They're qualified. "I want to join a board. I'd like to join a board." It's an important job. It's a good job, and I highly recommend it.

Danielle L. Scott: But then what are the pitfalls though? What should they be prepared to encounter as board members?

John Rehfeld: Well, the pitfalls are you want to make sure that you have-- this is not an old boys club, but you want to make sure you have the respect and the culture with the other board members. So if you're going to join a board, you should interview most, if not all, of the other board members, and that you can trust them, you can respect them, you can learn from them, they can learn from you. Same with the CEO and the CFO. So you want to make sure you're not going to join a bad board. You want to make sure you can join a board that can work together with management. It's also good to talk to the service providers, so the outside legal counsel, the outside auditing firm. The last two boards I've joined, I've talked to the service providers, the auditing firms, the legal counsel. The pitfalls is you get into a dysfunctional situation. You certainly want to have-- I mean, there is some legal exposure. Boards get sued. I think they're fairly well protected under something we'll call the Business Judgment Rule. I believe we have a few minutes, so if you want, I'll talk about that.

Danielle L. Scott: Yes, please.

John Rehfeld: But you still want to make sure that you have an indemnification, you have some directors and officer liability insurance, because there are-- they're called the plaintiff bar. There are people out there suing. Fortunately the most egregious of those-- Bill Arack [ph?] and his partner got tossed into jail. They got tossed into jail because they were sort of frauding these lawsuits. They were paying plaintiffs. But they're still lots of plaintiff bars out there that are suing companies. So a pitfall is you want to make sure you do your job the best way you do it. So there's a code of conduct, I'll say, for board members, and that's called the Business Judgment Rule. You need to do two things if you're a board member. You need to make sure you exercise duty of loyalty, and those are the actual words in this code of conduct rule, that you're not conflicted in any situation. And if you are conflicted, you have to fully disclose and step out of it. So are you exercising duty of loyalty? You don't have any self-interest in any decision. And the other one is duty of care. Have you exercised care in coming to this judgment? Have you brought in outside experts if you need to? Have you deliberated? So if you exercise the duty of loyalty and the duty of care, you fall under the protection of the Business Judgment Rule. There was a famous ruling, just came down about a year ago, on the Disney case, where the outside shareholders sued the board of directors and sued Michael Eisner because he did what appeared to be something very stupid in hiring Michael Ovitz and then firing him a year later and paying him a hundred-million-dollar-plus severance package. Well, the judge said the board members exercised duty of loyalty. Nobody was conflicted. Nobody got part of Ovitz's package. Nobody was related to Michael Ovitz. The board barely, but did exercise duty of care. They had lots of one-on-one meetings with themselves and with Michael Ovitz. He said barely, but they did make it. So he said the Business Judgment Rule prevails, and so this lawsuit has to go away. He made a very good statement. It's actually William Chandler III, and he came

and spoke at our Forum for Corporate Directors about a year ago. He said, "It's the rule of the marketplace to judge business decisions, not the rule of the courts." So if you follow the Business Judgment Rule, then let the marketplace pass judgment on that, not the courts. So that's a long answer, but a very important answer to what are the pitfalls.

Danielle L. Scott: My last question is for the students, like myself. What advice do you have for current and recently graduated MBA students? How should they prepare for today's job market? And, most importantly, you were once a newly graduated MBA student. So what did you wish you knew then?

John Rehfeld: I wished I knew then emotional intelligence. I was really good at IQ and I made it through a tough engineering program, made it through the MBA program. But I was pretty naïve. So I would pay more attention to emotional intelligence. Pepperdine has a really good introduction, at least or the program I teach in, of trying to help you become more self-aware. So self-awareness is very important. I'd pay a lot of attention to that. I'd say an MBA, combined with a technical degree, but even if not combined with a technical undergraduate, is a very powerful tool, and the marketplace looks positively for that tool. So not only do you learn something, but it has some marketability cachet, and you build a network. I'd say another thing I've learned is network, network, network. And virtually every job I've had and every board seat that I've been opportunitied to interview for has been through my network. So that's just the way it works.

Danielle L. Scott: Do you network in a strategic fashion? Do you keep lists of people that you can contact when you need them? How do you do it? Or is it more organic?

John Rehfeld: It's organic. I'm not even on LinkedIn. I'm not on Facebook. And I'm not saying that's right or wrong. I probably get an opportunity to join LinkedIn once a month, and I just have never taken the time to figure it out, because I'm at the stage of my life where I don't need the network to make a living. And I don't run around the Forum for Corporate Director meetings handing out business cards. But when I meet somebody, I'll follow up with an email. So email's been a very powerful tool. I probably spend 15 minutes a day just networking with people, passing along leads, going out of my way to help people. That's like pay if forward. That comes back, the payback. So I put in the time commitment of 15 minutes a day, let's say, to continually help people within my network. Another thing I'd say about newly graduating students, I would say in all fairness, it's a lot harder for you than it was for me. There were a lot of job opportunities for me. But there's still great opportunity out there. I'd be global. Fortunately, I got my global DNA reinforced with my experience with the Japanese companies, with Toshiba, and after Toshiba I went on to become president of Seiko Watch. So I got a lot of global experience. But global, self-awareness, network.

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Danielle L. Scott: Well, John, I think that's very sage advice. I think you've said it all. I just want to thank you once again for sharing your time and expertise with us. I've certainly been enlightened. So thank you.

John Rehfeld: Well, thank you, and so have I.

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