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Web of board members ties together Corporate America

By Matt Krantz, USA TODAY

The USA's worst period for corporate scandals in decades has made painfully clear how vital it is that a company's board of directors is qualified, actively involved and — above all — unbiased.

The problem is, that may not be the case. An analysis by USA TODAY and The Corporate Library reveals the boards of the nation's leading companies have a startling amount of overlap.

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Behind the controls of the nation's top businesses lurks an inner sanctum of friends, colleagues and partners who sit on corporate boards together. This clique of powerful people is supposed to oversee corporations and protect the rights of millions of shareholders.

Critics say that creates the potential for serious conflicts of interest and negates what is supposed to be an independent watchdog in Corporate America's system of checks and balances. "We're certainly not suggesting that every (relationship) indicates some sort of impropriety," says Ric Marshall, CEO of The Corporate Library. "But they do contain that potential."

Examples of the tight ties that bind together America's boards:

- Eleven of the 15 largest companies, including Pfizer and Citigroup, have at least two board members who sit together on another board.
- Of those 15 companies, four have at least two board members in common with another of the top-tier firms.

Those are in addition to other situations that corporate governance experts find even more troubling. Prime among them: CEOs who serve on one another's boards — such as Citigroup CEO Sandy Weill's relationship with AT&T that has drawn so much attention.

Granted, board-bashing is in vogue given the disastrous situations such as WorldCom and Enron. Yet corporate governance is still a subjective area where the gray outweighs the black-and-white. What one person sees as a potential conflict may be acceptable to another. And just because the opportunity for bias exists doesn't mean it occurs.

But the degree to which America's boards are connected shows that a lot of power is concentrated in relatively few hands. For shareholders who depend on directors to make sure companies are run well and honestly, the existence of this giant corporate web is another reason to suspect the USA's corporate system needs an overhaul.

Until now, the network of board ties has been largely invisible to anyone who doesn't have the time and experience to read and cross-reference regulatory filings. USA TODAY is giving readers a first look at the relationships among boardrooms. The corporate ecosystem is much more entangled than most investors might have thought.

Corporate Library, a corporate governance tracker, today is launching a database that examines companies' most-recent proxies as of July 1 to show how nearly 2,000 corporate boards and more than 22,000 board members are linked. On page 3B, USA TODAY used the database's findings to illustrate the board ties of the nation's 15 largest companies, including:

- Of the 11 that have at least two board members sitting together on another outside board, some totally unrelated companies are linked.

For instance, Pfizer, the giant drugmaker, shares at least two board members each with MetLife, J.P. Morgan Chase, Williams, Prudential Financial and Dell Computer. Procter & Gamble is similarly connected with General Motors, Alcoa and Rockwell Collins, which makes electronics for airplanes.

- Four share at least two board members with another of the 15 biggest companies. Telecommunications giant Verizon is linked this way with seven other companies, including other giants such as Procter & Gamble and ExxonMobil.

The potential for conflicts at these top companies is emblematic of the entire corporate food chain:

- In all, one-fifth of the 1,000 largest companies in the USA share at least one board member with another of the top 1,000, says Gerald Davis, governance expert and professor at the University of Michigan school of business.
- More than 1,000 board members sit on four or more corporate boards, and 235 sit on more than six.

"A great deal of concern has been raised over excessive CEO compensation levels and instances of unfettered greed," Marshall says. "The connections revealed here suggest that we should be equally concerned about excessive concentrations of power."

Corporate links

Most connected companies*

Ranked by their board of directors' degree of interconnectivity with other companies' boards.

Lucent
Marathon Oil
Morgan Stanley
AMR
Georgia-Pacific
Verizon
Allstate
Equifax
Electronic Data Systems
J.P. Morgan Chase
Most connected

Most connected directors*

Ranked on how connected they are with directors of other boards.

William H. Gray III
Willie D. Davis
Samuel A. Nunn Jr.

The degree of interlock that critics say is unacceptable varies. The narrowest definition is when two executives from two companies sit on each other's boards and are part of the committee that sets pay — something both the New York Stock Exchange and Nasdaq Stock Market regulate.

But The Corporate Library and others say an interlock exists when two or more corporate boards have at least one director in common. The argument: There's a chance of deals being struck behind the scenes. "Anytime you have two guys sitting on at least two boards, there's room for horse trading," says Lawrence White, professor at New York University.

All this may be interesting, but does it really matter? Yes, say researchers who have been studying the matter for years. For one thing, boards that are highly linked tend to get "blindsided" by changes in their industry because they don't see them coming, says Mason Carpenter, professor at the University of Wisconsin-Madison. Directors who sit on different boards together tend to gravitate toward a common way of thinking, says Eric Bonabeau, a researcher at Icosystem, a consulting firm that has used the laws of nature and science to study interlocks. "If we sit on boards together, we will tend to look at each other before making a decision," he says.

Directors who call themselves independent may often face conflicts with other directors. This raises serious doubts over whether board members make decisions for reasons other than the one they are supposed to: what's best for shareholders, Bonabeau says.

Stephen R. Hardis
Michael A. Miles
John W. Snow
Franklin A. Thomas
Edward A. Brennan
Shirley Ann Jackson
Ivan G. Seidenberg

* — Based on companies' most recent proxy filings as of July 1; Source: The Corporate Library

Even the harshest critics admit proving direct harm to shareholders because of overly cozy board members is tough. If a board rubber-stamps a business decision that turns out to be a bad move and costs the company money, there's still the question of whether the directors simply made a mistake or had sinister motives.

Still, appearances of improprieties exist. In perhaps the highest-profile example, regulators are looking into whether the board relationships between Citigroup CEO Weill and former AT&T chief C. Michael Armstrong caused a star analyst at Salomon Smith Barney to give AT&T stock an unmerited recommendation (story, 2B).

Another example has gone largely unnoticed. In September, Verizon left a group called Business for Affordable Medicine (BAM), which lobbies regulators to allow generic drugs into the market sooner. What was surprising about this is that Verizon, looking for ways to control health care costs, co-founded the group two years ago and helped recruit its corporate members, says BAM spokesman Brad Cameron. Verizon says it left BAM because the group sponsored legislation that the phone company opposed.

Verizon shares four board members with Wyeth, a prescription-drug maker and vocal opponent of BAM. Among directors serving on each other's boards: Wyeth Chairman John Stafford and Verizon CEO Ivan Seidenberg.

Wyeth says it didn't pressure Verizon. But without disclosing the recipients, Wyeth spokesman Lowell Weiner says the drugmaker did send several letters to Verizon expressing its disagreement with BAM.

By mining The Corporate Library's database tool and interviewing experts, USA TODAY found other situations that raise questions about just how independent directors really are:

CEO interlocks. Top executives sitting on one another's boards is the interlock that experts fear most. A big concern: A CEO looking to win support for a strategy could cut a deal with a CEO sitting on his board by agreeing to OK that CEO's plans as a director of his company, says Eliezer Fich, professor of finance at the University of North Carolina-Chapel Hill.

"There can be an acute vision of back-scratching," agrees White, who found that one in seven of the largest 500 firms have CEO interlocks.

Such an interlock exists between three seemingly unrelated firms: beer giant Anheuser-Busch, phone company SBC Communications and Emerson Electric, which makes products that control gases, liquids and electricity. A-B CEO August Busch III, Emerson Chairman Charles Knight and SBC CEO Edward Whitacre all sit on one another's boards. Spokespeople from A-B, Emerson and SBC confirmed that the three-way interlock exists but added it isn't a conflict.

Shared appointments. A CEO sitting on an outside board with one of his or her company's directors is a big concern. "This can compromise board governance," says Jim Westphal, management professor at University of Texas.

This type of arrangement is very common, Westphal says, adding that a third of directors sit on at least one other board with a CEO.

One example is at American Airlines' parent, AMR. Michael Miles, an executive at buyout firm Forstmann Little, sits on the AMR board with CEO Don Carty. Carty and Miles also sit on the boards of Dell and Sears. AMR spokesman Al Becker says there is no conflict. He points out that neither Carty nor Miles have any say in each other's compensation.

Bank ties. Major banks are at the center of many of the overlapping ties. Links spreading from the banks go so far that if a board member at J.P. Morgan Chase got a highly contagious disease, 97% of large corporate boards could be infected in about six months, Davis says.

For instance, Bank of America has at least two board members who also sit together on the boards of Alltel, Sara Lee, Sonoco, Knight Ridder and Lowe's. The connections go even deeper: Alltel, which provides banking software to hundreds of banks, continues to sell consulting services to Bank of America.

Bank of America, though, is aware of the issue and says it has improved it. Kenneth Lewis, named CEO on April 25, has removed all interlocks involving company executives. Before Lewis' changes, for instance, Alan Dickson, chairman of supermarket company Ruddick, sat on the committee at Bank of America that determined the salary of then-CEO Hugh McColl. McColl also sat on Dickson's board.

Dickson was replaced on April 25, 2001. Now, any two officers who sit on the same boards in addition to Bank of America have either retired or were asked to leave, says spokeswoman Eloise Hale. Further changes will be announced when the company releases its latest proxy next year.

If there is one thing that's clear, it's that the ties between boardrooms run deep and are likely to remain in some shape or form.

Corporate governance experts say, at the very least, investors should realize that some boards are so tangled that shareholders might not always be a director's top concern. "When you have an interlocking network, decisions are not based on intellect and logic, but rather what your friends decide," Bonabeau says.