FORGOTTEN GATEKEEPERS: EXECUTIVE SEARCH FIRMS AND CORPORATE GOVERNANCE

Omari Scott Simmons[*]

Many legal scholars do not readily associate executive search firms ("ESFs") with corporate governance, yet they are intimately connected with a key mechanism of corporate governance—elite labor markets. Corporate governance is a nexus of individual and environmental factors, a narrative of nature and nurture. Talent obviously matters, but legal scholars, courts, and policymakers overwhelmingly focus on structural mechanisms, procedures, and environmental factors. This Article makes an essential contribution to the corporate gatekeeper discussion by revealing how ESFs provide an assortment of private solutions to governance problems that scholars have attempted to address through legal and regulatory means. The ultimate success or failure of these private solutions may be instructive for designing more effective regulations, policies, and practices to promote better governance.

TABLE OF CONTENTS

* Howard L. Oleck Professor of Business Law & Director, Business Law Program, Wake Forest University School of Law; LL.M., University of Cambridge; J.D., University of Pennsylvania; B.A., Wake Forest University. I wish to thank Alan Palmiter, Andrew Verstein, Tom C.W. Lin, Randy J. Holland, E. Norman Veasey, and Eric Pikus for their insights. I wish to thank Lanie Summerlin, Samantha Tracy, and Ryan Gee for their valuable research assistance.

I. INTRODUCTION

The power and duty to manage corporations is vested in a board of directors that delegates tasks and functions to board committees.[1] It also delegates authority to senior executives and relies on experts.[2] Delegation and reliance are key pillars of modern corporate governance.[3] Recent scandals leading to the enactment of the Sarbanes-Oxley[4] and Dodd-Frank Acts[5] illustrate the prominent role of gatekeepers—lawyers, accounting firms, proxy advisory firms, investments banks, and ratings agencies—in limiting managerial shirking.[6] While the business literature recognizes the importance of executive talent, executive transitions, and succession for organizational adaptation,[7] legal scholars' emphasis on gatekeepers has largely ignored the influence of executive search firms ("ESFs").[8]

---

1. *See, e.g.*, DEL. CODE. ANN. tit. 8, §§ 141(c), 141(e) (2019); Robert E. Lamm, *Board Structure and Processes*, *in* 2 CORPORATE GOVERNANCE: LAW AND PRACTICE § 7.01[1] (Amy L. Goodman & Steven M. Haas eds. 2017).

2. Lamm, *supra* note 1, § 7.01[1].

3. *Id.*

4. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

5. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (codified as amended in scattered sections of 7, 12, 15, 18, 22 and 45 U.S.C.).

6. For a discussion of managerial shirking, see Oliver E. Williamson, *Opportunism and its Critics*, 14 MANAGERIAL & DECISION ECON. 97, 97, 100–03 (1993) [hereinafter Williamson, *Opportunism*] (defining opportunism as a range of activities involving "self-interest seeking with guile"); Oliver E. Williamson, *Strategy Research: Governance and Competence Perspectives*, 20 STRATEGIC MGMT. J. 1087, 1099 (1999) [hereinafter Williamson, *Strategy*] (describing opportunism in broad terms capturing "moral hazard, adverse selection, shirking, filtering, undisclosed subgoal pursuit, distortions, and all other strategic deceits").

7. *See, e.g.*, RAKESH KHURANA, SEARCHING FOR A CORPORATE SAVIOUR: THE IRRATIONAL QUEST FOR CHARISMATIC CEOS ix–xiii (2004); JEFFREY PFEFFER & GERALD R. SALANCIK, THE EXTERNAL CONTROL OF ORGANIZATIONS: A RESOURCE DEPENDENCE PERSPECTIVE 225–28 (2003); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 307–08 (1976).

8. Other academic disciplines have examined ESFs, particularly business scholars. *See, e.g.*, ELENA DOLDOR ET AL., GENDER DIVERSITY ON BOARDS: THE APPOINTMENT PROCESS AND THE ROLE OF EXECUTIVE SEARCH FIRMS 68 (2012); Susan M. Adams et al., *Orchestrating the Demise of All-Male Boards*, 24 J. MGMT. INQUIRY 208, 209 (2015); Ali C. Akyol & Lauren Cohen, *Who Chooses Board Members?*, 16 ADVANCES FIN. ECON. 43, 49–51 (2013); James Ang et al., *Efficient Labor and Capital Markets: Evidence from CEO Appointments*, 32 FIN. MGMT. 27, 27 (2003); Raine A. Brands & Isabel Fernandez-Mateo, *Leaning Out: How Negative Recruitment Experiences Shape Women's Decisions to Compete for Executive Roles*, 62 ADMIN. SCI. Q. 405, 411–14 (2017); Peter Cappelli & Monika Hamori, *Understanding Executive Job Search*, 25 ORG. SCI. 1511, 1516 (2014) [hereinafter Cappelli & Hamori, *Understanding Executive Job Search*]; Jay A. Conger & Edward Lawler III, *Building a High-Performing Board: How to Choose the Right Members*, 12 BUS. STRATEGY REV. 11, 12–15 (2001); George F. Dreher et al., *Mobility and Cash Compensation: The Moderating Effects of Gender, Race,*

ESFs play a key role in the market for executive talent and corporate governance.[9] Given their importance to the market for executive talent, firm management, board oversight, and corporate performance, ESFs require more intense examination.[10]

Legal scholars overwhelmingly focus on procedures, structural mechanisms, and environmental factors, but managerial talent and

and Executive Search Firms, 37 J. MGMT. 651, 652–55 (2011); James R. Faulconbridge et al., *The 'War for Talent': The Gatekeeper Role of Executive Search Firms in Elite Labour Markets*, 40 GEOFORUM 800, 801–05 (2009); Martin Gresty, *Market Intelligence Gathering in Executive Search Firms*, 31 BUS. INFO. REV. 206, 206 (2014); Monika Hamori, *The Maintenance and Performance Quality Standards in Executive Search Firms*, 7 ACAD. STRATEGIC & ORGANIZATIONAL LEADERSHIP 37, 38–41 (2002); Monika Hamori, *The Role of Clients in the Executive Search Process*, 7 ACAD. STRATEGIC & ORGANIZATIONAL LEADERSHIP 29, 31–33 (2002) [hereinafter Hamori, *The Role of Clients*]; Monika Hamori, *Who Gets Headhunted—And Who Gets Ahead? The Impact of Search Firms on Executive Careers*, 24 ACAD. MGMT. 46, 47–56 (2010); Ghee-Soon Lim & Claudia Chan, *Ethical Values of Executive Search Consultants*, 29 J. BUS. ETHICS 213, 215 (2001); Susan Meriliainen et al., *Headhunters and the 'Ideal' Executive Body*, 22 ORG. 3, 5 (2015); Harvey Meyer, *Boards Take on the Heavy Lifting*, 21 J. BUS. STRATEGY 18, 20 (2000); Paul Michelman, *In Boardrooms, the Same is a Shame*, 57 MIT SLOAN MGMT. REV. 1, 1 (2016); Daniel Muzio et al., *Towards Corporate Professionalism: The Case of Project Management, Management Consultancy, and Executive Search*, 59 CURRENT SOC. 443, 450 (2011); Barry Shulman & Gordon Chiang, *When to Use an Executive Search Firm and How to Get the Most Out of the Relationship*, 34 EMP. REL. TODAY 13, 13–16 (2007); Mark S. Van Clieaf, *Strategy and Structure Follow People: Improving Organizational Performance Through Effective Search*, 15 HUM. RESOURCE PLAN 33, 40–45 (1992); Guy C. Williams, *Eroding Ethics of Executive Search*, 12 CONSULTING TO MGMT. 51, 51–53 (2001); Peter Cappelli & Monika Hamori, *Who Says Yes When the Headhunter Calls? Understanding Executive Job Search Behavior* (Nat'l Bureau of Econ. Res., Working Paper No. 19295, 2013) [hereinafter Cappelli & Hamori, *Who Says Yes*]; Rakesh Khurana, *Three-Party Exchanges: The Case of Executive Search Firms and the CEO Search* (Harv. Bus. Sch., Working Paper, 2000); Thomas A. Clerkin, An Exploratory Study of the Antecedents and Consequences of Relationships with Executive Search Firms: Implications for a Model of Career Attainment (July 2005) (unpublished manuscript) (on file with author); Monika Hamori, Executive Search and Selection with Mediation: The Role of Executive Search Firms in Executive Succession (2004) (unpublished Ph.D. dissertation, U. Pa.) (on file with author).

9. *See* KHURANA, *supra* note 7, at 47–48; TOMAS MARTINEZ, THE HUMAN MARKETPLACE: AN EXAMINATION OF PRIVATE EMPLOYMENT AGENCIES 140–43 (1976); Faulconbridge et al., *supra* note 8, at 800–08 ("We argue that the rise of executive search firms, headhunters, as labour market intermediaries and their tactics for defining and managing contemporary elite labour recruitment practices is too often ignored.").

10. Faulconbridge et al., *supra* note 8, at 801 ("We argue that the rise of executive search firms, headhunters, as labour market intermediaries and their tactics for defining and managing contemporary elite labour recruitment practices is too often ignored. This is significant in a process-related sense because headhunters have manufactured themselves a position of power in elite labour recruitment that allows them to actively regulate labour markets. It is also significant because the activities of headhunters are integral to defining the nature of 'talent' in the contemporary economy.").

skill obviously matter as well.[11] Corporate governance is achieved through a nexus of individual and environmental factors, a narrative of nature and nurture.[12] ESFs' gatekeeper role intersects with various corporate governance debates in the academic literature addressing such issues as board composition (e.g., expertise, diversity, independence), executive compensation, and the market for executive talent.[13] Some observers go further to claim that ESFs play a prominent role in creating and regulating elite labor markets in addition to playing an integral role defining executive talent in the modern economy.[14] Notably, the contemporary ESF role encompasses a broader menu of services than traditional talent acquisition.

Part II analyzes the importance of gatekeepers to scholars, policymakers, and the governance of modern companies.[15] Part III explores the role of ESFs in modern corporate governance.[16] Part IV examines elite labor markets and the market for executive talent.[17] Part V articulates how reliance on experts is a ubiquitous feature of corporate law and governance.[18] Part VI highlights the areas of corporate governance where ESFs exert significant influence.[19] Part VII summarizes leading critiques of ESF intermediation.[20] Finally, Part VIII addresses the implications of ESF gatekeeping on the future of corporate governance.[21]

Ultimately, this Article breaks new ground in legal scholarship by: (i) illuminating the gatekeeping role of ESFs; (ii) analyzing ESFs' impact on modern corporate governance; and (iii) revealing how ESFs have already created a range of private solutions to governance problems that policymakers and scholars have attempted to solve through legal and regulatory means. The ultimate success, failure, and efficacy of these private solutions are instructive for designing regulations, policies, and practices that will promote better governance.

II. GATEKEEPERS

A. *Gatekeepers as a Governance Mechanism*

The Berle-Means corporation, a large public firm with fragmented share ownership and control vested in a board of directors divorced from ownership, is "well-ensconced in the American

11. *See id.* at 800.
12. *See id.* at 803.
13. *Id.* at 801.
14. *Id.*
15. *See infra* Part II.
16. *See infra* Part III.
17. *See infra* Part IV.
18. *See infra* Part V.
19. *See infra* Part VI.
20. *See infra* Part VII.
21. *See infra* Part VIII.

corporate governance firmament."[22] However, some observers cast doubt on whether it is an accurate reflection of the modern public corporation.[23] Stephen M. Bainbridge and M. Todd Henderson contend that such a board structure is outmoded and inefficient, and they propose that companies contract with a Board Service Provider ("BSP") to perform governance services, much like how they currently use consulting firms, accounting firms, law firms, and investment banks.[24] They question why a group of individuals (i.e., a board), some with loose connections to the corporation (i.e., independent directors), is better suited to render corporate services than an outside firm.[25] They attribute board dysfunction largely to the prevailing structure.[26] This Article does not address the broad question of whether the modern board should be replaced, yet it shares Bainbridge and Henderson's general observation about the extent to which board outsourcing is already happening as a matter of law and practice.[27] The rise of ESFs also reflects this trend.

Legal observers have examined a wide array of mechanisms to address the quintessential agency-cost problem that Adolf Berle and Gardiner Means described in the 1930s.[28] Historically, corporate

22. *See* Brian Cheffins, *The Rise and Fall (?) of the Berle-Means Corporation*, 42 SEATTLE U. L. REV. 445, 446 (2019) (asserting Berle-Means style corporation was the norm in the 1960s and 1970s rather than proclaimed in earlier periods); Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 11 (1991).

23. *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 865 (2013).

24. STEPHEN M. BAINBRIDGE & M. TODD. HENDERSON, OUTSOURCING THE BOARD: HOW SERVICE PROVIDERS CAN IMPROVE CORPORATE GOVERNANCE 1–15 (2018).

25. The independence or capture critique, even if we assume it is valid, is often accepted by observers without a robust inquiry or empirical validation and does not adequately explore demand-side benefits. *See, e.g.*, Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. L. 921, 921–22, 936 tbl.2 (1999) (showing an empirical study that independence of directors had no appreciable impact on share price); Donald C. Langevoort, *The Human Nature of Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 799 (2001) ("Current policymaking initiatives show an increasing tendency to assume the benefits of director independence and accountability, and hence the self-evident desirability of legal reforms to promote them.").

26. BAINBRIDGE & HENDERSON, *supra* note 24, at 1–15.

27. *Id.* Bainbridge and Henderson take a stronger position advocating fundamental change to modern board. *Id.*

28. *See generally* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932) (describing how the separation of ownership and control gives rise to conflicts of interest between shareholders and management); *see also* Williamson, *Opportunism*, *supra* note 6, at 97; Williamson, *Strategy*, *supra* note 6, at 1099; Robert P. Bartlett, III, *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA L. REV. 37, 48–52 (2006) (asserting that often both public and private firms face the same agency problems); Aleta G. Estreicher, *Beyond Agency Costs: Managing the*

lawmakers have been reluctant to upset the internal power relationships between management and shareholders or to address operational details.[29] Instead, lawmakers have (i) outsourced such reform to third-party gatekeepers, reputational intermediaries, and the market; (ii) emphasized symbolic procedures reflecting democratic values such as independence, participation, and transparency; and (iii) regulated business activity indirectly or outside the traditional corporate law context (e.g., tax, antitrust, environmental, banking, and labor laws).[30] John Coffee, in his seminal book *Gatekeepers*, identifies two strategies that have emerged among investors: (i) a legal strategy emphasizing ex post litigation to hold corporate managers accountable, and (ii) an ex ante gatekeeper function relying on professional agents (i.e., third parties) to monitor management and alert investors to opportunistic behavior.[31] Although this dichotomy may be too strict for some

Corporation for the Long Term, 45 RUTGERS L. REV. 513, 517 (1993) ("It is time to reexamine the 'managerialism' decried by Berle and Means and their modern-day counterparts. The preoccupation with agency costs has essentially blinded corporate scholars to these long-term costs to innovation and productivity."); Ronald J. Gilson & Charles K. Whitehead, *Deconstructing Equity: Public Ownership, Agency Costs, and Complete Capital Markets*, 108 COLUM. L. REV. 231, 231–32 (2008) (discussing the difference in agency costs between public and private ownership).

29. *See* STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 8–12 (2008) (discussing shareholder primacy, director primacy, managerialism and stakeholder theoretical approaches); Lyman Johnson & Dennis Garvis, *Are Corporate Officers Advised About Fiduciary Duties?*, 64 BUS. L. 1105, 1106–09 (2009).

30. *See* ROBERT CHARLES CLARK, CORPORATE LAW § 1.4, 30–32 (1986); JOHN C. COFFEE JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 9 (2006) (highlighting strategies that have emerged among investors); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 395 (1983) (highlighting the machinery of voting used by managers to seize power); Sidney A. Shapiro, *Outsourcing Government Regulation*, 53 DUKE L.J. 389, 389 (2003) (highlighting situations where government regulators have outsourced not only services but the origination and implementation of regulatory policy); Lawrence Mitchell, *Protect Industry from Predatory Speculators*, FIN. TIMES (July 8, 2009), https://www.ft.com/content/fac881b6-6be5-11de-9320-00144feabdc0 (highlighting the tension between envisioning the corporation as a democracy versus a bureaucracy). There are, however, numerous laws and regulations impacting business enterprise that should not be overlooked. *See id.*

31. Coffee describes key governance strategies:

> To reduce these asymmetries, investors have two basic strategies that they can follow: First, they can employ an essentially legal strategy and rely on litigation in order to hold their corporate managers and agents accountable and redress any breach of fiduciary duty or contract right. Second, the major alternative to such a law-centered system is to rely on gatekeepers—that is, on professional agents who will monitor management and alert shareholders as to opportunistic behavior by their managers. This latter system works less based on litigation or even private contracting, and more based on bonding and reputational capital. The first strategy works *ex post*, while the second operates *ex*

observers, the gatekeeper strategy illustrates the inevitability of outsourcing certain board responsibilities to independent third parties.[32]

The gatekeeper's intermediary function is essential to modern companies. Companies enlist an array of legal and extralegal mechanisms to combat opportunism and promote better firm governance.[33] Gatekeepers can be defined as "professional agents of the board and the shareholders who inform and advise them."[34] Ostensibly, private gatekeepers can prevent misconduct by withholding their support and cooperation from potential and actual wrongdoers.[35] In practice, "[t]his support—usually a specialized good, service, or form of certification that is essential for the wrongdoing to succeed—[is] the gate that the gatekeeper keeps."[36] Coffee contends that gatekeepers function as "some form of outside or independent watchdog or monitor—someone who screens out flaws or defects or who verifies compliance with standards or procedures."[37] He argues

> *ante*, seeking to detect and prevent problems before they become crises. The aim of both strategies, however, is to reduce informational asymmetries (and thereby produce a more transparent market).

COFFEE, *supra* note 30, at 9.

32. *See id.*

33. Lawrence A. Cunningham, *Comparative Corporate Governance and Pedagogy*, 34 GA. L. REV. 721, 722 (2000) ("I take the phrase 'governance' to mean the collection of law and practice that regulates the conduct of those in control of a business organization."). Other mechanisms of governance include: (i) the board of directors; (ii) markets (e.g., corporate control, capital markets, and labor); (iii) regulators and courts including public (e.g., securities regulation) and private enforcement mechanisms (e.g., shareholder litigation); (iv) institutional shareholders; (v) remuneration as a form of private contracting; and (vi) self-regulation. *Id.*

34. COFFEE, *supra* note 30, at 1.

35. Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 54 (1986) ("Gatekeeper liability is distinguished by the duty that it imposes on private gatekeepers to prevent misconduct by withholding support.").

36. *Id.* Sung Hui Kim further explains:

> Typically, the gatekeeper is an "outside professional services firm which has a contractual relationship with the primary enforcement target (the client). The gate has traditionally been that firm's specialized certification (e.g. legal opinion from a law firm, audit letter from an accounting firm) needed to consummate the client's securities transactions. And the specific mechanism has traditionally been the gatekeeper's professional duty to withhold services when it finds that it cannot vouch for the veracity of its client. Thus, by withholding the firm's certification, the gatekeeper warns the market and shuts the gate, effectively foreclosing the issuer's access to the capital markets.

Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411, 415 (2008).

37. COFFEE, *supra* note 30, at 2. For a discussion on how gatekeepers may assume a quasi-public watchdog role, see Merritt B. Fox, *Gatekeeper Failures: Why Important, What to Do*, 106 MICH. L. REV. 1089, 1089 (2008) ("Each of these professions can serve as a watchdog for the public. Each, at least in theory, has a particular position that allows for the acquisition of more information than the

that managers are held captive by their advisors to a certain extent.[38] Customarily, corporations employ several gatekeepers to help them manage and monitor business transactions.[39] The literature on gatekeepers raises important questions about how incentives, standards, and other forces affect their guidance and firm governance practices.[40]

B. *Third-Party Intermediaries, Exchanges, and Gatekeepers*

As an intermediary in the labor market for executive talent, ESFs facilitate the transaction between hiring firms and candidates that entails bridging gaps between unconnected parties and managing the flow of activity and information between them.[41] Most of the literature on third-party exchanges casts intermediary actions as opportunistic.[42] This characterization—though valid—is too narrow.[43] Nearly a century ago, Simmel, a German sociologist, identified three categories of third-party exchanges.[44] The first involves a third party connecting two competing parties, who otherwise would have no relationship, and exploiting their competition for personal gain.[45] The second, related category, involves a third party actively separating the other two parties to secure or preserve advantage: it divides and conquers.[46] These two categories highlight third party exploitation and underpin Professor Robert Burt's theory on structural holes.[47] Structural holes are gaps

investing public has about an issuer's prospects and that provides them an opportunity to warn the public when that information is different than the impression given by management in the issuer's disclosures."). Some scholars divide gatekeepers into two categories: public and private gatekeepers. *See* Peter B. Oh, *Gatekeeping*, 29 J. CORP. L. 735, 758–59 (2004) ("The public-private distinction between turns on the types of motivating considerations involved. On the one hand, market-based incentives drive private to maximize their own welfare against the costs of detection."); *see id.* at 742 ("But there are also public gatekeepers, such as regulatory agencies, which are motivated by pre-defined social goals."). ESFs fall into the private gatekeeper category.

38. *See* COFFEE, *supra* note 30, at 2.

39. Andre F. Tuch, *Multiple Gatekeepers*, 96 VA. L. REV. 1583, 1585 (2010) ("For business transactions, including high-stake offerings and mergers and acquisitions, a corporation will routinely engage a law firm, investment bank, and an accounting firm—and often several of each—to plan, negotiate, and execute these transactions. After all, business transactions are complex and raise myriad legal, financial, accounting and other hurdles for the corporations that undertake them.").

40. Oh, *supra* note 37, at 758–60.

41. *See* KHURANA, *supra* note 7, at 1–4.

42. Khurana, *supra* note 8, at 2.

43. *See id.* at 3–6.

44. *Id.* at 4.

45. *Id.*

46. *Id.*

47. RONALD S. BURT, STRUCTURAL HOLES: THE SOCIAL STRUCTURE OF COMPETITION 18–27 (1995).

between parties with complementary resources and information which are common in many markets.[48] They can be filled when two parties are brought together by a third party, such as an entrepreneur or an ESF, who may gain advantages.[49] In the third category of exchange, the intermediary is not necessarily an opportunistic actor who exploits the conflict, competition, or disunity to its advantage, but instead generates benefits by strengthening and cultivating unity between the parties.[50]

These distinct categories of exchanges are insightful. However, in practice, a third party's involvement in a transaction may reflect both opportunism and less self-serving behavior.[51] Drawing the line between the two is not always easy. These categorizations highlight the trade-offs implicit in third-party involvement.[52] Third-party involvement can both lower transaction costs and create transaction costs associated with a third party's own opportunism.[53] This dynamic affects three-party exchanges among employers, ESFs, and candidates.[54]

C. A Shift to Third Party Intermediaries in the Corporate Governance Context

1. Controlling Costs

The shift toward third party intermediaries is neither surprising nor coincidental. In make-versus-buy decisions, companies choose whether to provide services internally or procure them on the market.[55] Here, the decision to procure gatekeeper services is in part

48. Lawrence E. Mitchell, *Structural Holes, CEOs, and Informational Monopolies*, 70 BROOK. L. REV. 1313, 1321 (2005).
49. *Id.*
50. George Simmel, *The Number of Members as Determining the Sociological Form of the Group*, 8 AM. J. SOC. 1, 19 (1902); KHURANA, *supra* note 7, at 21.
51. Simmel, *supra* note 50, at 26.
52. *See id.*
53. *Id.* at 26–27.
54. Adam B. Badawi, *Interpretive Preferences and the Limits of the New Formalism*, 6 BERKELEY BUS. L.J. 1, 7 (2009).
55. *See, e.g.*, R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 392–95 (1937) (asserting that in order to minimize transaction costs, it may be optimal to bring various labor functions within the firm to prevent costly "spot" labor market transactions); Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes*, 19 J. ECON. LITERATURE 1537, 1537 (1981) [hereinafter Williamson, *Modern Corporation*] (arguing that the modern corporation evolved in part by a desire to reduce transaction costs and other economic factors) ("[T]he modern corporation is mainly to be understood as the product of a series of organizational innovations that have had the purpose and effect of economizing on transaction costs."); *see generally* ALFRED D. CHANDLER, STRATEGY AND STRUCTURE: CHAPTERS IN THE HISTORY OF THE INDUSTRIAL ENTERPRISE (1962) (discussing strategic diversification of the modern corporation); Oliver E. Williamson, *The Vertical Integration of Production: Market Failure*

cost-related, but it also serves to limit liability, signal "good" governance practices, manage corporate complexity, and shift accountability.[56]

2. *Limiting Liability*

Corporate law and corporate governance are most concerned with procedures that serve as heuristics for good governance.[57] Courts are reluctant to review the substance of countless business decisions provided that sound procedures were followed.[58] In this sense, hiring and relying on a third-party expert may insulate directors from liability.[59] Jurisprudence surrounding Delaware General Corporation Law § 141(e) illustrates this function.[60]

3. *Signaling "Good" Governance*

Apart from legal liability, using third-party experts has become synonymous with good governance.[61] Directors' decisions made without consulting third-party experts may appear ad hoc, hasty, pro forma, and biased. Optics matter.[62] Ideally, processes followed by directors must not only be *fair*, but also *seem* fair.[63] Adhering to a number of seemingly "democratic" procedures and principles signals

Considerations, 61 AM. ECON. REV. 112, 112 (1971) [hereinafter Williamson, *Vertical*] (analyzing the benefits of internalization versus external procurement).

56. Williamson, *Modern Corporation*, *supra* note 55, at 1540.

57. Güler Aras & David Crowther, *Governance and Sustainability: An Investigation into the Relationship Between Corporate Governance and Corporate Sustainability*, 64 MGMT. DECISION 433, 441 (2008).

58. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). Robert Clark describes the business judgment rule as follows: simply the business judgment of the directors will not be challenged or overturned by courts or shareholders, and the directors will not be held liable for the consequences of their exercise of business judgment—even for judgments that appear to have been clear mistakes—unless certain exceptions apply. ROBERT CHARLES CLARK, CORPORATE LAW § 3.4, 123–24 (1986); *see also* FRANKLIN A. GEVURTZ, CORPORATION LAW 278–79 (2000) ("The idea underlying the rule is that courts should exercise restraint in holding directors liable for (or otherwise second guessing) business decisions which produce poor results or with which reasonable minds might disagree. This seems to be a sensible notion. After all, business decisions typically involve taking calculated risks.").

59. Marc I. Steinberg & James Ames, *From the Regulatory Abyss: The Weakened Gatekeeping Incentives Under the Uniform Securities Act*, 35 YALE L. & POL'Y REV. 1, 1 (2016).

60. *See generally* DEL. CODE. ANN. tit. 8, § 141(e) (2016) (providing insulation from liability for directors relying on materials produced by experts).

61. Elisse B. Walter & Matthew A. Daigler, *Gatekeepers Are the Key to Good Governance*, FORBES (June 21, 2010, 4:49 PM), https://www.forbes.com/2010/06/21/shareholders-risk-gatekeepers-elisse-walter-leadership-governance-ethisphere.html#6fb8c54a10da.

62. *See id.*

63. Zoran Vukcevic, *Importance of Corporate Governance*, 2 INT'L J. ECON. & L. 147, 147–48 (2012).

deliberation, inclusion, transparency, and fairness to stakeholder constituencies.[64]

4. *Managing Corporate Complexity*

In theory, the board of directors manages the modern corporation; that is, it delegates management authority to the Chief Executive Officer ("CEO") and senior executives.[65] However, it is largely a part-time body, meeting intermittently. Moreover, the complexity of the modern corporation and its governance requires a broader range of skills and expertise than a single company may contain.[66] Observers, like the late Professor Alfred Chandler Jr., assert that delegation to professional management was necessary to address transaction costs for the complex, modern, multi-divisional, publicly traded company.[67] Arguably, the greatest functional innovation in the development of the modern corporation was the emergence of the M-form, or multidivisional corporation, with "many distinct operating units and management by a hierarchy of salaried executives."[68]

A key strategy in addressing complexity is the process of delegation: that is, when a board of directors delegates to board

---

64. *Id.*

65. DEL. CODE ANN. tit. 8, § 141(a) (2019).

66. Board members when surveyed admit keeping up with myriad issues is a challenge. *See* Jay W. Lorsch, *Boardroom Challenges: Lessons from the Financial Crisis and Beyond*, *in* THE FUTURE OF BOARDS: MEETING THE GOVERNANCE CHALLENGES OF THE TWENTY-FIRST CENTURY 15 (Jay W. Lorsch ed., 2012).

67. *See generally* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977) (examining the way in which management of US companies has become increasingly systematic).

68. BAINBRIDGE, *supra* note 29, at 74–75; CHANDLER, *supra* note 55, at 309–10. Chandler specifically described the benefits of the M-form:

> The basic reason for [the M-form's] success was simply that it clearly removed the executives responsible for the destiny of the entire enterprise from the more routine operational activities, and so gave them the time, information, and even psychological commitment for long term planning and appraisal. . . . [T]he new structure left the broad strategic decisions as to the allocation of existing resources and the acquisition of new ones in the hands of a top team of generalists. Relieved of operating duties and tactical decisions, a general executive was less likely to reflect the position of just one part of the whole.

Id.; *see also* Williamson, *Modern Corporation*, *supra* note 55, at 1565 ("The efficiency incentive to shift from the earlier U-form to the M-form structure is partly explained in managerial discretion terms: the older structure was more subject to distortions of a managerial discretion kind—which is to say that opportunism had become a serious problem in the large U-form firm."). *But see* ROBERT F. FREELAND, THE STRUGGLE FOR CONTROL OF THE MODERN CORPORATION: ORGANIZATIONAL CHANGE AT GENERAL MOTORS, 1924–1970, 305 (Mark Granovetter ed., 2001) ("The GM case suggests that the textbook M-form is most appropriate as a mechanism for owner control when the division of labor among owners, top executives, and line managers is moderate but not extensive.").

committees and senior executives and relies on third-party gatekeepers.[69] Why do some corporate boards and human resource ("HR") departments decide to outsource or delegate CEO or director hiring to ESFs? Part of the answer lies in corporate complexity and the high-stakes environment in which corporations function. The subsequent sections will examine this question in more detail.[70]

5. *Shifting Accountability*

Although the law is clear that directors are ultimately responsible for managing the corporation, outsourcing tasks and services to intermediaries arguably makes them and the companies they serve less accountable.[71] In a sense, outsourcing shifts responsibility to third-party gatekeepers, whose incentives, operating procedures, and degrees of external and internal regulation are often unclear to those outside the gatekeeper industry.[72]

A board of director's engagement of an ESF can be viewed as a way to shift responsibility for important hiring decisions.[73] For high-profile hires in large corporations, using an ESF is a best practice and a prudent risk-mitigation strategy.[74] A sitting CEO severely constrains a board's options, and a poor hire may lead to scandal, share price declines, and top employees' defection to other companies.[75] The stakes behind CEO and director hires are extremely high. When engaged in hiring, directors want stakeholders to perceive them as diligent, deliberative, and procedurally fair.[76] Engaging a reputable ESF to manage the process provides additional cover, signaling that directors have exercised sound business judgment.

6. *Legitimization*

ESF participation signals legitimacy to hiring firms and candidates. Companies and candidates are embedded in a broader community of "overlapping business and social relationships."[77] The process and procedures employed by a third-party ESF must convey a sense that the hiring company has operated appropriately in conducting the search.[78] An overture from an ESF, which has a contractual obligation to the client to find a candidate, may appear more acceptable and less awkward to the candidate than a direct call

69. *See* BAINBRIDGE, *supra* note 29, at 73–75.
70. *See infra* Part III.
71. *See* BAINBRIDGE & HENDERSON, *supra* note 24, at 42–46.
72. *See id.*
73. *See* Khurana, *supra* note 8, at 27–29.
74. *Id.*
75. *See id.* at 16.
76. *See id.* at 35.
77. *Id.* at 33–34.
78. *See id.* at 34.

from a competitor. ESF participation may also minimize the candidates' perception of bias.[79]

III. FUNCTION OF EXECUTIVE SEARCH FIRMS

In today's business headlines, highlighting the hiring of a new CEO who brings expertise, vision, and potential transformation to a company, is commonplace.[80] Behind the scenes is the work of ESFs, yet their role as gatekeepers has largely escaped the attention of legal scholars.[81] In fact, their intermediation in the labor market for executive talent is pivotal because corporate managers, directors, and CEOs play an essential role in firm governance and sustainability.[82] Most proposals to improve corporate governance pertain to the roles of corporate managers.[83] Hence, this article focuses on CEO and board-level recruitment and other ancillary governance-related services.

ESFs, known colloquially as "headhunters," provide search, recruitment, placement, and other services for corporate clients with specific executive and senior executive needs.[84] In the market for elite talent, client companies are the buyers; candidates are the sellers; and ESFs bring them together as third-party intermediaries. Generally, ESFs develop search strategies and position specifications to meet the clients' needs (e.g., culture, expertise, etc.).[85] They research, identify, screen, interview, and verify candidate qualifications and engage in final-offer negotiations.[86] The scope of their services often extends beyond traditional talent-acquisition to a range of services, such as leadership consulting, succession planning, and board assessment.[87]

79. *See id.* at 35.

80. *See* Jenna Fisher, *2018 Q1 Fortune 500 CEO Transitions*, RUSSELL REYNOLDS ASSOCIATES (Apr. 30, 2018), https://www.russellreynolds.com/insights/thought-leadership/2018-q1-fortune-500-ceo-transitions; *see also* Deena Shanker, *Campbell Shares Rise After Earnings Beat Estimates Under New CEO*, BLOOMBERG (Feb. 27, 2019), https://www.bloomberg.com/news/articles/2019-02-27/campbell-shares-rise-after-earnings-beat-estimates-under-new-ceo.

81. *See* Khurana, *supra* note 8, at 5–6.

82. *See* Paul H. Zalecki, *The Corporate Governance Roles of the Inside and the Outside Directors*, 24 U. TOL. L. REV. 831, 832 (1993).

83. *See, e.g.*, D. Gordon Smith, *Corporate Governance and Managerial Incompetence: Lessons from Kmart*, 74 N.C. L. REV. 1037, 1045 (1996).

84. *See* JOHN A. BYRNE, THE HEADHUNTERS 1–2 (1986).

85. IBRAHIM YUCEL, IBISWORLD INDUSTRY REPORT OD5670: EXECUTIVE SEARCH RECRUITERS IN THE US 5 (2016).

86. *Id.* at 7.

87. *See, e.g.*, *Board & CEO Services*, KORN FERRY, https://www.kornferry.com/solutions/talent-acquisition/board-and-ceo-services (last visited Sept. 18, 2019); *What We Do*, SPENCER STUART, https://www.spencerstuart.com/what-we-do (last visited Sept. 18, 2019).

A. Origins of Executive Search Firms

In 1926, Thorndike Deland founded the first ESF in New York City.[88] His business model constituted charging client companies a fixed-rate retainer fee of $200 and a five percent commission on the value of the hired candidate's first-year salary.[89] The post-World War II massive industrialization boom and the growth of the modern corporation culminated in this watershed moment.[90] The "war-thinned ranks of many corporations in the 1940s" created a shortage of top executive talent.[91] At the same time, the rapid growth of postindustrial economies created a demand for elite labor and specialized skills.[92]

The ESF industry was based in part on the growing belief that corporate managers were interchangeable from company to company and industry to industry.[93] In the past, executives and other employees stayed with the same company for most of their careers. ESF intermediation helped to catalyze corporate executives' migration and concomitant increases in pay.[94] According to one observer, "The Organization Man of the Fifties" gave way to the "Migrant Manager of the Eighties,"[95] when this evolving paradigm increased significantly.[96] One study captured a twenty-five percent decline in the tenure of Fortune 100 executives between 1980 and 2001.[97] In 2001, McKinsey & Co. produced a report declaring a "war for talent" and predicted that the future success of companies would be defined by their ability to recruit and retain top executives who could drive innovation in a knowledge-based economy.[98] Between 2001-2003, large employers used ESFs to fill fifty-four percent of positions with salaries greater than $150,000.[99] This number is even more impressive considering that firms typically filled their

88. JONATHAN V. BEAVERSTOCK ET AL., THE GLOBALIZATION OF EXECUTIVE SEARCH: PROFESSIONAL SERVICES STRATEGY AND DYNAMICS IN THE CONTEMPORARY WORLD 43 (2015); Heather Phelps, *History of Retained Executive Search*, PHELPS GROUP (Jan. 20, 2014), http://www.phelpsgroup.ca/2014/01/history-of-retained-executive-search/.

89. BEAVERSTOCK ET AL., *supra* note 88, at 43.

90. *See id.*; *see also* ASS'N OF EXEC. SEARCH & LEADERSHIP CONSULTANTS, EXECUTIVE SEARCH IN TRANSITION: A STRATEGIC STUDY OF EXECUTIVE SEARCH PROFESSION 4 (2010).

91. BYRNE, *supra* note 84, at 16.

92. Faulconbridge et al., *supra* note 8, at 801; *see* CHANDLER, *supra* note 55.

93. BYRNE, *supra* note 84, at 22.

94. *Id.* at 4–5.

95. *Id.* at 2.

96. *Id.*

97. Cappelli & Hamori, *Understanding Executive Job Search*, *supra* note 8, at 1512.

98. *See* ED MICHAELS ET AL., THE WAR FOR TALENT 3 (2001); Faulconbridge et al., *supra* note 8, at 800.

99. Cappelli & Hamori, *Understanding Executive Job Search*, *supra* note 8, at 1512.

remaining vacancies through internal promotion.[100] Now, most senior-level external hiring in this area is performed through ESFs.[101] Their ubiquitous presence not only facilitates transactions in elite labor markets but also actively contributes to the elite labor market structure.[102]

ESFs historical link to large professional service firms is instructive. Modern ESFs derived from the search functions of large management consultancies and accounting firms like McKinsey & Co., Booz Allen & Hamilton, and Peat Marwick Mitchell.[103] For example, Spencer Stuart (established 1956) and Heidrick and Struggles (established 1953) emerged from the management consultancy Booz Allen & Hamilton, whereas Korn Ferry (established in 1969) emerged from the large accounting firm Peat Marwick Mitchell.[104]

1. *Conflicts*

Large professional service firms generally had thriving search functions up until the 1970s.[105] The reason they left executive searches up to ESFs was rooted in conflicts of interests that arose between their executive search functions and other departments.[106] For example, management consultants "could simply recommend changes in personnel and collect from a corporation twice: once for producing the study and again for producing a candidate."[107] They also had an ethical problem: raiding the long list of their client companies for candidates.[108]

Similarly, large accounting firms initially entered the search business by sending their own employees, those less likely to make partner, to work for clients. Placing other suitable but unaffiliated candidates with clients might prevent them from receiving lucrative work in their audit or other departments.[109] They also responded to regulatory pressures from the Securities and Exchange Commission ("SEC") in 1978 by not recruiting for their SEC-registered clients.[110] Once again, potential conflicts of interests could deter service firms from offering candid opinions and advice that would upset clients.[111]

100. *Id.*
101. *See id.*
102. *See* Khurana, *supra* note 8, at 9.
103. BEAVERSTOCK ET AL., *supra* note 88, at 44.
104. *Id.* at 43. Executive search pioneers such as Gardener Heidrick, John Struggles, Sid Boyden, Spencer Stuart, Lester Korn, and Richard Ferry worked at either Peat Marwick Mitchell or Booz Allen & Hamilton prior to establishing their own firms. *Id.* at 44.
105. *Id.* at 44; BYRNE, *supra* note 84, at 26–28.
106. BEAVERSTOCK ET AL., *supra* note 88, at 43.
107. BYRNE, *supra* note 84, at 27.
108. *See id.*
109. *See id.* at 27–28.
110. *Id.* at 28.
111. *See id.* at 27.

These regulatory pressures coupled with the inability to place candidates with a long list of accounting, auditing, and management consulting clients prompted large professional service firms to exit the search business.[112]

The historical and present connection between the consolidation and diversification of large professional service firms and the growth of ESFs is quite interesting. ESFs originated as departments within larger management consulting and accounting firms, spun-off to address conflict concerns and increasing regulatory scrutiny, and will probably face related areas of concern as they expand their menu of service offerings.[113] Ironically, they now find themselves competing with major management consulting firms, accounting firms, and other professional service providers.[114]

2. Outsourcing Human Resources

Corporate HR departments might be reluctant to conduct executive searches due to the expertise, time, and resources needed.[115] In addition, an HR director charged with hiring a future superior, such as a CEO or board member, might be influenced by incentives inconsistent with the company's objectives.[116]

When companies engage ESFs, they are in essence outsourcing the corporate HR function. Observers contend that ESFs' significant market power can be attributed in part to a "transformative role, changing elite labour search from being in-house and through internal labour markets to a 'global' process."[117] ESFs offer new avenues of hiring beyond customary networks that are more homogeneous and restricted.[118] Some observers assert that "the 'old boys network' has been comprehensively dismissed as a flawed strategy for recruitment, and executive search firms have put themselves forward as the new best-practice for elite labour recruitment."[119] Nevertheless, this optimistic view has its critics.[120]

In the 1970s, the growth of privacy regulations influenced more companies to engage ESFs.[121] ESFs can discover what corporations cannot ask, including delicate personal questions (e.g., about alcohol abuse, community relations, character), as well as securing references and information that a candidate's colleagues would often refrain from giving.[122] In addition to this deeper and more robust vetting,

112. *Id.* at 28.
113. BEAVERSTOCK ET AL., *supra* note 88, at 43.
114. *Id.* at 69.
115. *See* Faulconbridge et al., *supra* note 8, at 804.
116. *See* BYRNE, *supra* note 84, at 22.
117. Faulconbridge et al., *supra* note 8, at 803.
118. *Id.* at 802–03.
119. *Id.* at 804.
120. *See id.*
121. BYRNE, *supra* note 84, 22–23.
122. *Id.*

engaging ESFs prevents corporations from directly poaching talent from their rival corporations and serves their vanity: an ESF absorbs the awkwardness of making an offer, only to be turned down.[123]

B. Current State of the ESF Industry

In 2016, ESFs accounted for $7.2 billion in revenues and $551.5 million in profits.[124] The industry is characterized by low market concentration and low barriers to entry.[125] Aside from the five large global ESFs that constitute twenty-seven percent of the industry, hundreds of small and medium-sized boutique firms, normally sole proprietorships with a single consultant, predominate the profession.[126] These boutique firms usually focus on a specific industry or geographic region.[127] Recently, mergers and acquisitions by larger ESFs boasting strong client relationships have enhanced consolidation.[128]

The five global multi-office ESFs that dominate the market for executive talent are Korn Ferry (8.7%), Spencer Stewart (4.9%), Heidrick & Struggles International Inc. (4.8%), Egon Zehnder International Inc. (4.3%), and Russell Reynolds (4.3%).[129] Korn Ferry and Heidrick & Struggles are public companies.[130] Russell Reynolds is a private corporation,[131] and Spencer Stuart and Egon Zehnder International Inc. are partnerships.[132] They each offer a broader range of services than small and medium-sized ESFs.[133]

C. Scope of Services

The scope of services ESFs provide extends beyond traditional talent acquisition. In 2016, industry-wide, traditional, retained C-level executive search services were expected to constitute 44.1% of industry revenues. Additionally, other executive search services, including mid-level professional searches, were estimated to

123. *Id.* at 23–24.
124. YUCEL, *supra* note 85, at 4.
125. *Id.*
126. *Id.* at 8, 22. Typically, smaller firms are formed when an experienced consultant leaves a well-established larger practice to start their own. A strong client list is also key to the establishment of successful small and medium-sized ESFs. *Id.* at 25–26.
127. *Id.* at 22.
128. *Id.* at 8–9 ("For example, major player Korn Ferry acquired Boston-based Global Novations LLC in 2012 for $35.0 million, followed by the acquisition of PDI Ninth House for $80.0 million in 2013. Likewise, Heidrick and Struggles International Inc. (Heidrick and Struggles) purchased Senn-Delaney Leadership Consulting Group LLC (Sean Delaney) in 2013.").
129. *Id.* at 27–29.
130. *Id.* at 27–28.
131. *Id.* at 29.
132. *Id.* at 28–29.
133. *See id.*

constitute 46.5%, and other executive management services were estimated to constitute 9.4%.[134]

1. *Retained Executive Search*

Retained executive search services are generally provided on a retained fee basis where clients are billed for a specific recruitment assignment often for positions with annual compensation exceeding $250,000, such as C-Level positions, board appointees, and mid-tier management positions.[135] These consultant fees are based on a proportion (e.g., thirty to forty percent) of the position's first-year salary.[136]

2. *Contingency Executive Search*

In contingency executive searches, the ESF receives compensation only after the position is filled.[137] These searches typically focus on mid-level management positions (e.g., vice presidents, regional managers) where the salary range is below the base-level executive salary of $250,000 but higher than $100,000.[138] Despite the large proportion of revenue generated by this sector, the share has fallen over the past five years.[139] This is because client companies increasingly use their own internal HR departments to recruit and hire mid-level managers or to promote from within to save money. Competition from internal HR departments is due largely to cost reduction.[140] This cost-driven move saves companies significant fees: ESFs can charge up to forty percent of the hire's first-year salary.[141] Competition from internal HR departments has been aided by increased use of online and social networking sites, particularly LinkedIn.[142]

3. *Executive Management Services*

Despite a general industry trend toward specialization, large ESFs like Korn Ferry, Spencer Stuart, and Heidrick and Struggles have broadened their traditional portfolio of placement services to include a menu of additional services.[143] Offering consultation related to (1) organizational strategy; (2) rewards and benefits; (3) assessment and succession; (4) leadership development; and (5) culture shaping has boosted ESF profit margins, and revenues

134. *Id.* at 15–16.
135. *Id.*
136. *See id.* at 16.
137. *Id.*
138. *Id.*
139. *Id.*
140. *Id.* at 8.
141. *Id.* at 24.
142. *Id.*
143. *Id.* at 14.

attributable to these services continue to grow.[144] To illustrate, "standard executive search and placement services accounted for only 58.1% of Korn Ferry's 2016 net sales, down from an 74.5% share in 2011."[145] In 2016, seven percent of Heidrick & Struggles revenues were attributable to its leadership-consulting segment and six percent to its culture-shaping segment.[146] Large ESFs are making acquisitions in part to offer a broader range of services for their corporate clients.[147] An Association of Executive Search Consultants ("AESC") survey predicts that the executive management services most in demand will include succession planning, board advisory, leadership effectiveness, and internal talent assessment.[148] This expansion has brought ESFs into more direct competition with large management consultancies, the same types of firms from which they emerged.[149]

D. Demand for ESF Services

According to the AESC, the global demand and outlook for ESFs is strong.[150] Demand for traditional talent acquisition services and executive management services is heavily influenced by global economic conditions, especially management restructuring activity, changes in corporate profits, and general outsourcing and globalization trends.[151] Compared to internal HR departments, large ESFs like Korn Ferry and Spencer Stuart have a competitive advantage: their global connections and expertise allow them to recruit from an international talent pool.[152] Notably, all of the largest ESFs have offices around the world; for example, "Korn Ferry has only 20 offices across the United States and Canada, with the remaining 68 offices spread across 27 other countries."[153] Domestically, ESF office locations generally track the level of business concentration, economic activity, and population density.[154] Three U.S. regions boast the highest percentage of industry establishments: mid-Atlantic (twenty-two%), southeast (21.2%), and

144. *Id.* at 16.
145. *Id.*
146. *Investor Relations*, HEIDRICK & STRUGGLES, http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9Mzc1NjI4fENoaWxkSUQ9LTF8VHlwZT0z&t=1&cb=636288923621166489 (last visited Sept. 18, 2019).
147. YUCEL, *supra* note 85, at 22.
148. *See* ASS'N OF EXEC. SEARCH & LEADERSHIP CONSULTANTS, AESC GLOBAL EXECUTIVE TALENT OUTLOOK 2018 SUMMARY REPORT 3–4 (2018), https://www.aesc.org/sites/default/files/uploads/documents/publications/2018_AESC_Global_Executive_Talent_Outlook_Report.pdf.
149. *See id.*
150. *See id.*
151. YUCEL, *supra* note 85, at 17.
152. *See id.*
153. *Id.* at 19.
154. *Id.* at 21.

the west (15.5%).[155] Other drivers of external demand include: (i) profits of client companies; (ii) business sentiment as reflected in indices; (iii) number of businesses in the United States; (iii) unemployment rates; and (iv) competition from internal HR departments.[156] As profits increase, companies have a greater ability to invest in external recruitment services.[157] Increases in the Institute of Supply Management business-sentiment index often correspond to increased U.S. business performance in a given year as well as increased expansion of operations, restructuring, and demand for ESF services.[158] The total number of U.S. businesses with one or more employees also impacts the demand for ESF services, but a higher national unemployment rate means more available candidates, and companies will find it easier to conduct their own searches.[159] Finally, competition from internal HR departments naturally affects demand for ESF services, especially for mid-level management placement.[160] A 2015 AESC survey indicated that forty-two percent of companies said they were more likely to use internal HR recruiting resources for mid-level salary positions, while seventy-four percent preferred using ESFs to recruit C-level candidates.[161] Technological change and disruption also pose a competitive threat, especially to small and medium-sized ESFs.[162] Internal HR departments can use LinkedIn and other platforms to enhance their own recruitment capabilities.[163] On the other hand, some large ESFs leverage a global network and their own internally developed, proprietary applications for client use.[164]

ESF "industry revenue is expected to grow at an average annual rate of 2.3% to $8.0 billion over the next five years."[165] While "[i]ncreased competition from external sources will also constrain industry profitability[,] . . . this trend will be offset as firms increasingly offer higher-margin talent management solutions as a part of a broader executive management services portfolio."[166] Notwithstanding ESF growth and expansion, it is important to note that certain types of firms (e.g., private equity) may not use ESFs even in today's corporate environment. Instead, they may rely on

155. *Id.*
156. *Id.* at 5–6.
157. *Id.* at 5.
158. *Id.*
159. *Id.* at 5–6.
160. *Id.* at 25.
161. *Id.*
162. *Id.* at 31.
163. *Id.*
164. *Id.*
165. *Id.* at 5.
166. *Id.*

their own short list or stable of executives for their portfolio companies.[167]

E. ESF Regulation

Corporate cases and SEC regulations specifically address the work and potential conflicts of other types of intermediaries—auditors, bankers, lawyers, compensation consultants[168]—but ESFs, with similar potential conflicts, have largely evaded scrutiny by Delaware courts, litigants, and the SEC.[169] This is important as ESFs expand into other lucrative service offerings that affect governance. Beyond settlements and regulatory agreements in the midst of corporate scandals, structural changes to the business models of intermediaries, such as firewalls between investment bank departments, were adopted to minimize conflicts of interest that might ultimately mislead client corporations.[170] The interplay of conflicts in a multifunctional professional service firm remains an area of regulatory concern.[171]

Despite ESFs' important role, they operate with limited industry-specific regulatory oversight.[172] They are still subject to general regulatory requirements for businesses, which are more extensive for ESFs operating in various countries.[173] Confidentiality, non-disclosure, data privacy, and cybersecurity regulations are areas of concern, given the collection, storage, and sharing of data between clients and candidates.[174] The conflicts that sparked their original spin-off are instructive for their past, present, and future regulation. The potential for conflicts in practice becomes more salient as their portfolios expand to include executive-management services.[175]

---

167. *See* Discussion with senior ESF Professional (Dec. 2, 2018).

168. Suzanne Barlyn, *Exclusive: Citi Can Promote Executive Tied to Grubman Scandal*, REUTERS (Apr. 25, 2012, 3:16 PM), https://www.reuters.com/article/us-citi-equities-head/exclusive-citi-can-promote-executive-tied-to-grubman-scandal-idUSBRE83O17520120425.

169. *See e.g.*, In re The Walt Disney Co. Derivative Litig., 907 A.2d 693, 765 (Del. Ch. 2005) (emphasizing the role of the board of directors as final decision makers rather than scrutinizing experts, such as an ESF).

170. These conflict concerns by loose analogy are reflected in the spinning scandals of the early 2000s where large investment bank equity research departments gave high ratings to dot.com companies in exchange for lucrative investment banking business. David Teather, *Analyst Sandal Costs Wall St $1.4 Billion*, GUARDIAN (Apr. 28, 2003, 9:00 AM), https://www.theguardian.com/business/2003/apr/29/8.

171. *See* YUCEL, *supra* note 85, at 32–33.

172. *Id.*

173. *Id.*

174. Karen Greenbaum, *Executive Search and Data Privacy: Four Questions Clients and Candidates Should Ask*, FORBES HUM. RESOURCE COUNCIL (June 11, 2018), https://www.forbes.com/sites/forbeshumanresourcescouncil/2018/06/11/executive-search-and-data-privacy-four-questions-clients-and-candidates-should-ask/#11751be13af0.

175. *See* YUCEL, *supra* note 85, at 32–33.

ESFs are largely self-regulated but adhere to the Professional Code of Conduct created by their leading professional association, the AESC.[176] Established in 1959, it includes over 350 executive search and leadership consulting firms and provides training and education opportunities to over 9,000 individual members operating in more than seventy countries.[177] Most importantly, it is instrumental in creating industry standards and professional guidelines, especially in areas related to senior executive and board member searches, privacy, confidentiality, and diversity.[178] Specifically, AESC's Code of Professional Practice embraces principles supporting diversity and inclusion, protecting confidentiality, and avoiding conflicts of interest.[179]

IV. ELITE LABOR MARKETS AND THE MARKET FOR EXECUTIVE TALENT

A. Market for Executive Talent

Most scholarly attention focuses on the demand-side concerns of client companies, neglecting the supply-side factors that influence candidates to enter a search process—or not.[180] The decision is intuitive: executives face uncertainty about their future careers with their current employers and elsewhere.[181] Unsurprisingly, studies have found that potential candidates in very attractive positions are less likely to enter a search,[182] and those facing greater uncertainty about their career prospects are more likely to enter searches.[183] Candidates who have a broad set of experiences or varied skill sets are more likely to enter searches because they have more to learn and more alternatives.[184]

What features or failings of elite labor markets for CEOs and directors make ESF intermediation necessary? First, the market for executive talent is not robust given the small number of buyers and

176. *About AESC*, ASS'N OF EXEC. SEARCH & LEADERSHIP CONSULTANTS, https://www.aesc.org/about-us/about-aesc (last visited Sept. 19, 2019); *Prospective Members*, ASS'N OF EXEC. SEARCH & LEADERSHIP CONSULTANTS, https://www.aesc.org/membership/prospective-members (last visited Aug. 19, 2019); *Board & Council*, ASS'N OF EXEC. SEARCH & LEADERSHIP CONSULTANTS, https://www.aesc.org/about-us/board-councils (last visited Sept. 19, 2019).

177. *See About AESC*, *supra* note 176.

178. *Code of Professional Practice*, ASS'N OF EXEC. SEARCH & LEADERSHIP CONSULTANTS, https://www.aesc.org/profession/professional-code (last visited Sept. 19, 2019).

179. *Id.*

180. Cappelli & Hamori, *Understanding Executive Job Search*, *supra* note 8, at 1524.

181. *Id.*

182. Cappelli & Hamori, *Who Says Yes?*, *supra* note 8, at 3.

183. *Id.*

184. *Id.*

sellers.[185] Second, both parties face high risks if a transaction becomes public prior to completion. Third, institutional gaps separate buyers and sellers.[186] ESFs help to address these problems, among others.

1. A Nonrobust Labor Market

On the demand side, relatively few CEO positions open up each year. From the supply side, qualified executive talent is perceived as scarce.[187] If perception matches reality, the market for CEOs and directors has only a small number of buyers and sellers.[188] In markets with many buyers and sellers, the process of matching and finding an exchange partner is relatively routine, but in restricted markets, finding an exchange partner often requires intensive research.[189] For example, candidates and employers may not be aware of the full range of trading partners. To achieve a good match, the company and candidate must communicate their interests to one another, and usually, they also need to have some degree of familiarity with one another.[190] ESFs are well-positioned to initiate, develop, and even define the relationship between the parties.[191]

2. Risk to Buyers and Sellers

Companies searching for leaders naturally want to keep their options open and consider several candidates, which requires not favoring any one candidate early in the process and maintaining confidentiality.[192] A poorly handled search could significantly damage a candidate's reputation, and even successful candidates do not wish to learn they were the third, fourth, or fifth option.[193] Taking a risk-averse approach, corporate boards engage ESFs.[194]

On the supply side, by taking a call from a prospective employer, potential candidates, especially external candidates, run serious risks. For example, a premature disclosure that an employee is considering a job at another company and, even more problematic, a competitor, can have irreversible career damage.[195] A disclosure that the search was unsuccessful can circulate and potentially stigmatize

185. David F. Larcker, *Labor Market for Executives and CEO Succession Planning*, STAN. GRADUATE SCH. BUS., CTR. LEADERSHIP DEV. & RES., https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-quick-guide-07-ceo-succession.pdf (last visited Sept. 19, 2019).
186. KHURANA, *supra* note 7, at 27–35.
187. *Id.*
188. *Id.*
189. *See id.* at 26–27.
190. *Id.*
191. *Id.* at 47–48.
192. *Id.* at 32–33.
193. *Id.* at 33.
194. *Id.* at 127–28.
195. Khurana, *supra* note 8, at 14.

the candidate, irrespective of the reasons.[196] Leaks regarding searches can cause desirable candidates to withdraw, disavowing any interest in a position. Leaks also signal dysfunction and dissension within an organization.[197] Despite any internal disagreement, boards want to present a unified front to candidates.[198]

Confidentiality looms large. ESFs must seek information regarding a candidate's skills, capabilities, temperament, and character.[199] The current employer may be off limits, therefore alternative sources are needed.[200] The hiring company's own directors may supply information and contacts.[201]

Although directors can hire and fire a CEO, for practical purposes, they are constrained and depend on the CEO for information flow. Quickly removing an established CEO or new hire can have financial and reputational costs for the board and the company.[202] Board options with respect to sitting CEOs may be limited.[203] ESFs can reduce these risks through a disciplined and carefully managed search process. [204]

3. Institutional Gaps between Companies and Candidates

CEO candidates are fairly passive job seekers, who are usually employed at another firm. To the degree possible, ESFs must discern the level of interest and the intentions of both the hiring company and the candidates. High-status external candidates will not want to waste their time if an internal candidate is heavily favored. Similarly, the hiring company will not want to waste time with a candidate who is not very interested but simply using the process as a negotiating tactic with a third party. The ESF goes back and forth between the hiring company and the candidate to overcome roadblocks and create a level of comfort. Without such intervention, we have a "deep-play" situation: a scenario where parties have so

196. *Id.*
197. American Express had leaks that revealed factions on the board who supported different candidates. *Id.* at 15.
198. *Id.*
199. *Id.*
200. *Id.*
201. *Id.*
202. *See, e.g.*, Ben Levisohn, *Does a CEO Change Mean Your Stock Will Rise?*, BARRON'S (May 28, 2016), https://www.barrons.com/articles/does-a-ceo-change-mean-your-stock-will-rise-1464409120; *see also* Max Landsberg, *In Search of Excellence in CEO Succession: The Seven Habits of Highly Effective Boards* 1 (Mar. 15, 2006), https://www.maxlandsberg.com/leaders/CEO-7-steps.pdf; *Tough at the Top*, ECONOMIST (Oct. 25, 2003), https://www.economist.com/special-report/2003/10/25/tough-at-the-top; Rakesh Khurana & Nitin Nohria, *The Performance Consequences of CEO Turnover*, 39 TBL. 2 (Mar. 15, 2000), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=219129.
203. Khurana, *supra* note 8, at 16.
204. *Id.*

much at stake from a utilitarian standpoint that participation may be irrational.[205]

ESFs can expand the number of potential candidates through their networks. The process involves first approaching and then convincing a candidate to quit his or her current job to take a new one. In this insecure context, the relationship between a candidate and hiring company can become tense, distant, and fragile.[206] External candidate searches may be viewed with apprehension given the information gaps and perceived risks. Moreover, not hiring from within could signal an organization's failure to develop and value internal talent and poor succession planning.[207] Information delivered through an ESF may be perceived as more trustworthy since both parties are familiar with its agents and reputation.[208]

When hiring companies handle all aspects of an external search, they can become frustrated by perceived "unreasonable" candidate demands for compensation and delays.[209] In this context, participation of a third-party ESF can help to resolve intense and sensitive negotiations by dampening emotions and communicating candidate demands to the hiring company in a more objective and conciliatory tone (and vice versa).[210] Acting as a buffer, ESFs reduce the risks of participation in the CEO labor market for hiring firms and candidates alike. ESFs control information flow between the parties, improving efficiency and preventing overload and emotional interactions.[211] More importantly, ESFs can cultivate greater trust between the parties by resolving conflict, irrespective of the negotiation's outcome.[212] Their involvement signals legitimacy to unsuccessful candidates, outsiders, and stakeholders.[213] The perception of their objectivity makes the outcomes credible to both the internal and external parties.[214]

Beyond adding structure to the transaction, ESFs cultivate a working relationship between the parties. The egos and career concerns of parties whose reputations are perhaps their greatest asset, makes searches inherently risky for both sides.[215] Hiring

205. CLIFFORD GEERTZ, THE INTERPRETATION OF CULTURES 432 (1973); KHURANA, *supra* note 7, at 144.

206. Khurana, *supra* note 8, at 26–34.

207. Neil Amato, *Poor Talent Management Hinders Companies' Growth, Innovation*, FIN. MGMT. (Sept. 18, 2012), https://www.fm-magazine.com/news/2012/sep/20126410.html.

208. Khurana, *supra* note 8, at 20.

209. *Id.* at 17–18.

210. Khurana, *supra* note 8, at 18–19. ESF engagement can also help bridge other types of institutional constraints. For example, competitors cannot exchange cost information with competitors.

211. *Id.*

212. *Id.* at 20–34.

213. *Id.*

214. *Id.*

215. *Id.* at 28–29.

companies do not want to commit too early to avoid risking potential embarrassment and difficulty in securing a first-choice candidate.[216] Candidates' careers may be at risk if their interest in another company is disclosed prematurely. They may also be stigmatized and embarrassed if they are not chosen.[217] ESFs serve as a buffer for high-status parties who might otherwise not engage in an external search. They are more like facilitators, communicators, and mediators than brokers.[218]

B. Anatomy of a CEO Search

The section below outlines the dynamics for "genuine" CEO searches—that is, when an internal candidate is not already assured the job, and the external search is not mere theater.[219] These searches require serious effort to identify external candidates.[220]

Large public and privately-held companies decide whether to "make or buy" administration and management of the search process, often engaging ESF services when filling senior posts.[221] One of two things happens before a company contacts an ESF: (i) a CEO unexpectedly announces he or she is resigning; or (ii) the board decides that a CEO must be replaced and determines that no internal candidate is suitable or that the internal candidate should be benchmarked against a slate of outside candidates.[222] Wall Street directors feel a sense of urgency about filling such vacancies. The hiring of a CEO has implications for stock price and reactions of market participants and observers.[223]

Many scholars and industry insiders have mapped the search process.[224] Blue Steps, an industry resource for executives, describes ten steps: (1) meeting with the client; (2) analyzing the client in depth; (3) analyzing the market and creating candidate specifications; (4) developing the search strategy; (5) generating a list of names and identifying candidates; (6) approaching the candidates, qualifying, and interviewing them to create a short list; (7) basic referencing and presenting the short list to the client; (8) narrowing the list to three to five candidates through referencing; (9) making the offer and

216. *Id.* at 28.
217. *Id.*
218. *Id.* at 27.
219. *Id.* at 20–21.
220. *Id.* at 21.
221. *See generally* Williamson, *Modern Corporation*, *supra* note 55 (discussing the organization of the modern corporation); Williamson, *Vertical*, *supra* note 55 (discussing the organization of vertically integrated corporations).
222. Khurana, *supra* note 8, at 21.
223. Levisohn, *supra* note 202.
224. *See, e.g.*, Gresty, *supra* note 8, at 207.

negotiating; and (10) onboarding and further negotiating.[225] Note that an initial list of fifteen to twenty candidates will be narrowed to three to four finalists, and the directors commonly interview the final candidates only once.[226]

CEO searches have both extensive and intensive phases.[227] The extensive part of the search process involves defining candidate specifications (i.e., job descriptions) and defining the candidate pool.[228] During this phase, tasks are often divided between the ESF and the directors.[229] ESFs often do not get involved until after directors have performed preliminary tasks. Generally, the extensive phase involves joint discussions between the board and ESF to yield a detailed job description of the ideal candidate following a careful assessment of a company's unique operational and strategic challenges.[230]

The solicitation and generation of names is particularly important in identifying external CEO candidates.[231] ESFs rarely start searches from scratch.[232] Although ESF consultants are likely to have direct industry experience and familiarity with, or knowledge of, senior executives who might entertain the open position, directors play the primary role in defining specifications and identifying the majority of potential candidates, often using their personal networks and contacts.[233] The ESF may add a "dark horse" and other candidates, but most names emerge from discussions with the directors.[234] The directors' weighted role is often attributed to their specific knowledge of the business and its challenges. They are likely current or former CEOs and senior executives with extensive social capital related to the industry or its context.[235] The ESF refines and

225. *Id.* (see chart); *see also* BlueSteps, *10 Steps of the Executive Search Process* (Mar. 1, 2015), https://www.bluesteps.com/blog/the-10-steps-of-the-executive-search-process.aspx.
226. Khurana, *supra*, note 8 at 32.
227. *Id.* at 22; *see also* Faulconbridge et al., *supra* note 8, at 802. Faulconbridge offers a chronology of the search process:
Mapping the market – using a researcher and consultant's knowledge and contacts to list competing firms where suitable candidates could be found and to seek out background information on and contacts for suitable individuals.
Using the firm's database to search for suitable candidates.
Sourcing – using known contacts and individuals in the firm's database to elicit recommendations for possible candidates.
Id.
228. Khurana, *supra* note 8, at 22.
229. *Id.*
230. *Id.* at 21.
231. *Id.*
232. *Id.*
233. *Id.* at 21–22.
234. *Id.* at 25.
235. *Id.* at 21–22.

facilitates the directors' work during this phase, especially the specification list.[236]

The company may then decide to economize by outsourcing the collection of general information to the ESF, which can provide a value-added service.[237] In this phase, it assesses the work histories, salaries, and educational backgrounds of the initial candidates to trim the list of those who are "nearing retirement."[238]

The intensive phase of the search is conducted primarily by the directors who rely on their personal contacts—often other directors who have first-hand experience with the candidates—to secure more detailed information on their capabilities.[239]

C. Anatomy of a Director Search

ESFs can also be enlisted to secure directors for a board.[240] The avenues through which directors are nominated to boards are diverse: nominating committees, CEO recommendations, and ESF recommendations.[241] In the corporate governance arena, non-officer, independent directors have received considerable attention from regulators and scholars over the past decade.[242]

ESF services intersect with the important task of hiring qualified independent directors.[243] A study of the nomination process, relying on disclosures from proxy statements, provides some preliminary insights. It found that ten percent of all inside director nominations and twenty-two percent of independent director recommendations come from ESFs.[244] Meanwhile, twenty-two percent of independent director recommendations come from CEO recommendations, and twenty-five percent from the nominating committee.[245] Overall, the study reveals the trend toward greater use of ESFs for independent director searches.

Ideally, the first step in the board-consulting engagement should be a discussion, assessment, and creation of an overall board-composition strategy.[246] This strategy is rooted in several factors, including: (i) "changing business strategies"; (ii) "strong board governance and risk management"; (ii) "board expertise and diversity

236. *Id.* at 26–27.
237. *Id.* at 22.
238. *Id.* at 26–27.
239. *Id.* at 22.
240. Akyol & Cohen, *supra* note 8, at 9.
241. *Id.* at 3–4.
242. *Id.* at 6–7.
243. Khurana, *supra* note 8, at 23.
244. Akyol & Cohen, *supra* note 8, at 14.
245. *Id.*
246. ASS'N OF EXEC. SEARCH & LEADERSHIP CONSULTANTS, BOARD SEARCH & ADVISORY SERVICES GUIDING PRINCIPLES DESIGNED TO DELIVER CLIENT-CENTERED RESULTS 3 (2016), https://www.aesc.org/sites/default/files/uploads/documents-2015/AESC_Board_Search_&_Advisory_Guiding_Principles.pdf.

mix"; (iii) "board refreshment strategies"; and (iv) "succession planning."[247] The search generally involves the following steps. First, in consultation with the client company, the ESF develops a candidate profile, brief, or prospectus aligned with the board-composition strategy.[248] Second, ESFs ideally identify a long, diverse list of candidates who meet the client-identified requirements and other candidates who may not meet the detailed requirements exactly but "are intriguing in terms of experience, capabilities, and fit."[249] This phase might involve ESFs educating clients about the talent pool and the need to focus on candidates' capabilities rather than taking a more restrictive view of candidates defined by their traditional experiences.[250] Here, ESFs may attempt to manage potential unconscious bias.[251] Third, with significant client company input, the list is narrowed to candidates who will undergo a more involved assessment.[252] ESFs focus on delivering a slate of top candidates who fall within the client's board-composition strategy and will be interviewed by the board or its nominating/governance committee.[253] The final stage comprises interviews and candidate selection.[254] ESFs structure the interview process and ensure that board members are briefed on each candidate's background. They also may prepare candidates by giving them the appropriate background on the client's culture and strategy.[255]

ESF board engagement does not necessarily begin with a search and end with the hiring of a new member.[256] Boards retain ESFs to provide a range of ongoing advisory services which include: (i) assessing board culture and adapting it to a changing environment; (ii) creating an inclusive board culture; (iii) onboarding and inducting new board members; (iv) improving the relationship between the CEO and the board; and (v) clarifying the roles of the board, its committees, and individual members and evaluating their performance.[257] These board advisory services attempt to address a range of governance problems that some scholars, policymakers, and others attempt to address via regulatory means.

247. *Id.*
248. *Id.* at 4.
249. *Id.*
250. *Id.*
251. *Id.*
252. *Id.*
253. *Id.*
254. *Id.*
255. *Id.*
256. *Id.* at 5.
257. *Id.*

V. RELIANCE ON EXPERTS IN CORPORATE LAW AND GOVERNANCE

A. *Emergence of Nominating Committees*

For CEO searches, public boards will typically create a subcommittee simply called the "search committee," empowered to select the ESF.[258] However, the full board will ultimately be involved. By contrast, in the search for a director, the nominating committee drives the search process.[259]

The board nomination process has evolved significantly from rubber-stamping the CEO-recommended candidates.[260] According to Institutional Shareholder Services, ninety-nine percent of companies have a committee charged with nominating duties.[261] Generally, the New York Stock Exchange ("NYSE") and the NASDAQ stock exchange require listed companies to have audit, compensation, and nominating/governance committees composed solely of independent directors.[262] In 2003, the SEC adopted disclosure rules relating to the director-nomination process,[263] and they have become more specific.[264]

B. *Corporate Law Approach*

No Delaware cases have alleged that directors breached their fiduciary duties through their selection of, or reliance on, an ESF when hiring a CEO or appointing a director.[265] However, many high-profile CEOs are stepping down in the face of allegations of workplace misconduct that affect corporate reputation and value.[266] These concerns are amplified in the age of social media and instant, widespread, unverified information dissemination.[267] Delaware's

---

258. *See* Discussion with senior ESF Professional (Dec. 2, 2018).

259. ASS'N OF EXEC. SEARCH & LEADERSHIP CONSULTANTS, *supra* note 246, at 3–5.

260. Amy L. Goodman & Maia R. Gez, *The Nominating and Corporate Governance Committee*, *in* 2 CORPORATE GOVERNANCE: LAW AND PRACTICE § 8.01, 8.2 (Amy L. Goodman & Steven M. Haas, eds. 2017).

261. *Id.*

262. Lamm, *supra* note 1, § 7.01[4][b] at 7-16; NASDAQ Rule 5605(d) (2013). NASDAQ listing standards require companies to have a majority of independent directors perform the functions of the governance /nomination and compensation committees. *Id.* at 4350(c)(3)–(4).

263. Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors, 68 Fed. Reg. 69,204 (Dec. 11, 2003).

264. Goodman & Gez, *supra* note 260, at 8.2.

265. *See* In re The Walt Disney Co. Derivative Litig., 907 A.2d 693, 697–98 (Del. Ch. 2005).

266. Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583, 1583 (2018).

267. Dinah Brin, *Social Media Is a Major Consideration in Wave of Sexual Harassment Allegations*, SHRM (Dec. 11, 2017), https://www.shrm.org

statutory scheme and jurisprudence, reflected in such cases as *In re The Walt Disney Co. Derivative Litigation*[268] and *White v. Panic*,[269] along with cases addressing Delaware General Corporation Law § 141(e), are instructive for predicting how courts may treat such developments from a corporate law perspective.[270]

1. Statutory Scheme

Directors perform important decisionmaking and monitoring roles.[271] State corporation law permits the board to create and rely on committees.[272] Pursuant to § 141(e) of the Delaware General Corporation Law, directors can rely on the reports of experts.[273] Specifically, directors:

> [S]hall, in the performance of such member's duties be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by another person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.[274]

Relying on expert advice can fulfill the duty of care and serve as evidence of good faith and fair dealing.[275] Generally, the mere existence of the advice, rather than its substance, is relevant to the question of whether a board has exercised its duty of care.[276] Nonetheless, directors cannot blindly rely on expert reports.[277] Further, § 141(e) does not preserve deferential business judgment review of a board-approved transaction where the board is deliberately misled by management and its advisors; relies on reports based upon facts the directors know or should have known were false;

/resourcesandtools/hr-topics/technology/pages/social-media-major-consideration-in-wave-of-sexual-harassment-allegations.aspx.

268. 907 A.2d 693 (Del. Ch. 2005).
269. 783 A.2d 543 (Del. 2001).
270. *Id.* at 546.
271. *Id.* at 552–53.
272. DEL. CODE ANN. tit. 8, § 141(c) (2003).
273. *Id.* § 141(e).
274. *Id.*
275. Zucker v. Hassell, No. 11625-VCG, 2016 Del. Ch. LEXIS 180, at *23–26 (Del. Ch. Nov. 30, 2016); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1142 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995).
276. *See, e.g.*, In re Comverge, Inc. Shareholders Litig., No. 7368-VCP, 2013 Del. Ch. LEXIS 92, at *11 (Del. Ch. Apr. 10, 2013) ("[A] number of cases have held that it is the existence of legal advice that is material to the question of whether the board acted with due care, not the substance of the advice.").
277. *See Cinerama*, 663 A.2d at 1142.

or fails to "adequately consider or monitor an advisor's conflict of interest."[278]

Although Delaware courts have made clear that the § 141(e) defense is not unfettered, they still assert that plaintiffs must surmount a heavy burden to survive a Rule 23.1 motion to dismiss a duty of care case where directors have relied on an expert:

> [Plaintiffs must show that] (a) the directors did not in fact rely on the expert; (b) their reliance was not in good faith; (c) they did not reasonably believe that the expert's advice was within the expert's professional competence; (d) the expert was not selected with reasonable care by or on behalf of the corporation, and the faulty selection process was attributable to the directors; (e) the subject matter . . . that was material and reasonably available was so obvious that the board's failure to consider it was grossly negligent regardless of the expert's advice or lack of advice; or (f) that the decision of the Board was so unconscionable as to constitute waste or fraud.[279]

For legal and practical purposes, as long as directors rely in good faith on experts, they are unlikely to face legal liability and second-guessing by courts.[280] Ultimately, the corporation is managed "by or under the direction of a board of directors."[281] Pursuant to § 141(e), an expert's role is "to assist the board's decisionmaking" rather than supplant it.[282] Legally, directors need not follow expert recommendations to the letter but may exercise their own judgment, even if frequently consulting and relying on third-party guidance.[283]

278. Steven M. Haas, *Legal Duties and Responsibilities of the Board*, *in* 1 CORPORATE GOVERNANCE: LAW AND PRACTICE, § 4.03[2], 4-2 (Amy L. Goodman & Steven M. Haas eds., 2018). *See* Gantler v. Stephens, 965 A.2d 695, 710–12 (Del. 2009); *see also* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1283–84 (Del. 1988); In re Rural Metro Corp. Stockholders Litig., 88 A.3d 54, 90 (Del. Ch. 2014) ("Another part of providing active and direct oversight is acting reasonably to learn about actual and potential conflicts faced by directors, management, and their advisors."); In re Del Monte Foods Co. Shareholders Litig., 25 A.3d 813, 836 (Del. Ch. 2011) (holding that stockholder had reasonable probability of success proving directors breached their fiduciary duties when they were deceived by corporation's financial advisor); Valeant Pharm. Int'l v. Jerney, 921 A.2d 732, 751 (Del. Ch. 2007) (declining a § 141(e) defense); California Public Emps.' Ret. Sys, Inc. v. Coulter, 2002 Del. Ch. LEXIS 144, at *46 (Del. Ch. Dec. 18, 2002) (asserting that a special committee of the board should not have reasonably relied on valuation reports).

279. Brehm v. Eisner, 746 A.2d 244, 262 (Del. 2000) (asserting the plaintiff's burden to survive a Rule 23.1 motion to dismiss a duty of care case where directors relied on an expert).

280. Haas, *supra* note 278, § 4.03[5].

281. DEL. CODE ANN. tit. 8, § 141(a) (2003).

282. In re The Walt Disney Co. Litig., 907 A.2d 693, 770 n. 550 (Del. Ch. 2005); *see also* Ronald J. Gilson, *The Devolution of the Legal Profession: A Demand Side Perspective*, 49 MD. L. REV. 869, 889 (1990).

283. Mindy K. Goldberg, Note, *The Business Judgment Rule, Due Care and Experts: How Much Information Is Enough*, 7 J.L. & COM. 225, 240–41 (1987).

As a functional matter, various corporate decisions are outsourced to third parties—lawyers, bankers, accountants, consultants, proxy advisory firms, and ESFs.[284]

2. Case Law

a. *In re The Walt Disney Company Litigation*

The Walt Disney Company's hiring of Michael Ovitz as its president is an example of board ineffectiveness and dysfunction.[285] Pursuant to § 141(e), the *Disney* court analyzed the board's reliance on and use of a compensation consultant, Graef Crystal, as part of the hiring and negotiation process.[286] Notably, the Disney board and its Chair and CEO Michael Eisner did not use an ESF when engaging Ovitz.[287] Would the use of an ESF have provided more evidence of good faith and fair dealing from a legal perspective? However speculative, it seems likely considering Eisner's friendship with Ovitz and well-documented steering and domination of the hiring process.[288]

b. *White v. Panic*

In *White v. Panic*, the plaintiffs' complaint alleged that "the board of directors affirmatively refused to take any measures to stop or sanction sexual misconduct by a corporate officer [CEO and board chairman] that allegedly subjected the corporation to potential civil liability and expense."[289] The plaintiffs also claimed that the board's decision to use corporate funds to facilitate the CEO's payment of the $3.5 million settlement of a paternity suit was not a valid exercise of business judgment.[290] Although *White v. Panic* does not involve a hiring decision, it sheds light on the wide discretion boards may exercise in the employment context and their responsibilities.

Citing *Brehm v. Eisner*,[291] the Delaware Supreme Court affirmed the Court of Chancery's dismissal in *White v. Panic*, asserting

> [i]t is not within our province to express a view on the morality of the alleged conduct of the corporate officer or the business decisions of the board in its handling of that conduct.[292] Our role is to review de novo the legal sufficiency of the complaint in

284. *Id.*
285. Brehm v. Eisner, 746 A.2d 244, 249 (Del. 2000).
286. *Disney*, 907 A.2d at 770–71.
287. *Id.* at 699–700.
288. *Id.*
289. White v. Panic, 783 A.2d 543, 546–47 (Del. 2001).
290. *Id.* at 552.
291. 746 A.2d 244 (Del. 2000).
292. *White*, 783 A.2d at 546.

> accordance with the standard of review established in our jurisprudence.[293]

Accordingly, the court found that: (i) the "facts alleged in the complaint do not support a reasonable inference that the board knew about the officer's misconduct but intentionally decided not to sanction the officer or to curb future misconduct"; and (ii) facts were insufficient "to support an inference that the board acted in bad faith or wasted corporate assets by using corporate funds to pay settlements and expenses connected with the harassment suits."[294] The court noted that the complaint was based almost entirely on facts derived from an investigative report in *U.S. News & World Report*.[295]

The business judgment rule protects employment decisions ranging from hiring, firing, compensation, relying on outside advisors, and settling sexual harassment lawsuits.[296] With respect to settlements, directors are afforded the presumption of having acted in good faith.[297] Even their awareness of lawsuits and resulting settlements does not establish that they knew these suits were meritorious or that a company officer engaged in the conduct alleged.[298] Also, most allegations of corporate waste related to settlement decisions are likely to fail, given the heightened standard of liability.[299]

Delaware's statutory scheme and jurisprudence provide significant protections to directors in hiring decisions.[300] Directors and officers are unlikely to face liability for breaching their oversight duties due to flawed corporate cultures.[301] However, since they ostensibly set the cultural and ethical tone for the entire organization, they may impede effective management of legal compliance, risk, and

293. *Id.* (citing *Brehm*, 746 A.2d at 253–54.
294. *Id.* at 547.
295. *See* Miriam Horn, *Sex and the CEO*, U.S. NEWS & WORLD REPORT, July 6, 1998, at 32.
296. *See White*, 783 A.2d at 551.
297. *See* Perrine v. Pennroad Corp., 47 A.2d 479, 487 nn.6–7 (Del. 1946) (discussing "honest business discretion" of directors in deciding whether to settle lawsuits); *see also* Feldman v. Pennroad Corp., 155 F.2d 773, 775–76 (3d Cir. 1946).
298. *See White*, 783 A.2d at 553 n.31.
299. *See* Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000) (describing the waste as "'an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration'") (quoting Glazer v. Zapata Corp., 658 A.2d 176, 183 (Del. Ch. 1993)); Grobow v. Perot, 539 A.2d 180, 189 (Del. 1988) (holding that a waste determination depends on "whether 'what the corporation has received is so inadequate in value that no person of ordinary, sound business judgment would deem it worth that which the corporation has paid.'") (quoting Saxe v. Brady, 184 A.2d 602, 610 (Del. Ch. 1962)).
300. *See Brehm*, 746 A.2d at 251.
301. Stone v. Ritter, 911 A.2d 362, 365 (Del. 2006); In re Caremark Int'l Inc., 698 A.2d 959, 961–63 (Del. Ch. 1996).

corporate malfeasance.[302] The failure to account for flawed cultures, irrespective of legal liability, risks damaging companies' economic and societal bottom lines.

The legitimacy of U.S. corporate law is often judged from a procedural perspective, where procedures serve as a heuristic for quality governance, but they do not necessarily capture important cultural and behavioral dynamics.[303] For example, a common feature of most corporate compliance programs is an employee code of conduct that serves as a written reflection of a preferred culture and behaviors.[304] When unwritten rules, practices, and patterns undermine it, directors and officers are unlikely to be held liable as long as they did not have knowledge of the wrongdoing, and officially sanctioned written procedures were followed.[305]

C. Securities Law Approach to Gatekeepers

SEC regulations form a disclosure-based regime consistent with a market paradigm.[306] Following the Sarbanes-Oxley and Dodd-Frank Acts, regulator emphasis on companies using outside advisors, especially audit firms and compensation consultants, has increased.[307] The SEC requires disclosures of the nomination process and disclosures in the proxy statement, illustrating the importance of the nominating committee.[308] NYSE listing standards grant the nominating committee sole authority to retain and terminate ESFs.[309]

Institutional investors have expressed concern over the ability of outside advisors to render independent judgment when, for example, they are providing advice to both a board committee and management.[310] Their fear of losing lucrative services may impede upon their independence and objectivity to the detriment of the client corporation.[311] In response to this concern, the SEC amended Item 407 of Regulation S-K to require greater disclosure of conflicts of interest from compensation consultants.[312] The Dodd-Frank Act

302. *See, e.g.*, *Caremark*, 698 A.2d at 960–61.

303. *See id.*

304. H. Lowell Brown, *Corporate Director's Compliance Oversight Responsibility in the Post Caremark Era*, 26 DEL. J. CORP. L. 1, 138 (2001).

305. *Id.*; *see also* Omari Simmons, *Responsibility for Flawed Corporate Cultures*, JOTWELL (Apr. 5, 2019), https://corp.jotwell.com/responsibility-for-flawed-corporate-cultures/ (reviewing Jennifer G. Hill, *Legal Personhood and Liability for Flawed Corporate Cultures*, (Eur. Corp. Governance Inst. Law Working Paper No. 413/2018 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3309697).

306. *See* Lamm, *supra* note 1, § 7.01(2)(b) at 7-6.

307. *Id.* § 7.10, at 7-39–41.

308. *Id.* § 7.01(4)(b) at 7-16.

309. *Id.* § 7.10 at 7-40.

310. *See id.* § 7.04(a) at 7-14.

311. *Id.*

312. 17 C.F.R. § 229.407(e) (2018).

requires compensation committees to consider conflicts of interest and independence-related factors when procuring advisory services, and the SEC adopted similar rules.[313] ESFs raise similar questions about conflicts, especially as they expand into other service offerings for companies. Yet ESFs generate less attention from regulators. Should they? There is a valid question whether investors would respond to more information regarding ESFs and executive searches.

VI. ESF ENGAGEMENT WITH CORPORATE GOVERNANCE ISSUES

ESFs function within a high-stakes talent-acquisition environment.[314] Hiring C-level and other senior executives and board members requires decisions with legal, operational, financial, and reputational risks that affect the entire corporate enterprise and many stakeholders,[315] From a corporate law perspective, the prospect of director liability related to a hiring process involving an ESF is likely de minimus.[316] However, other categories of legal liability can be significant.[317] From an operational perspective, corporate scandals are disruptive and have foreseeable and unforeseeable ripple effects inside and outside the organization.[318] The ubiquitous presence of social media amplifies these concerns. An abrupt leadership change can also affect employee morale and performance regardless of the new executive's conduct.[319] In the hiring context, any misstep that impugns the company's reputation has wide ramifications. ESFs intersect with all these areas at the forefront of corporate governance.[320]

A. *Board Composition*

1. *Independent Directors*

Independent directors have become a permanent fixture of corporate governance, generating considerable scholarly criticism.[321]

313. The SEC adopted rules on this topic in 2012. Listing Standards for Compensation Committees, Securities Act Release No. 33-9330, Exchange Act Release No. 34-67220, Investment Company Act Release No. S7-13-11, 77 Fed. Reg. 38,421 (June 27, 2012) (to be codified at 17 C.F.R. pts. 229 & 240).

314. *See* KHURANA, *supra* note 7, at 32–35.

315. Khurana, *supra* note 8, at 14–15.

316. *See* KHURANA, *supra* note 7, at 47–48.

317. Haas, *supra* note 278, at § 4.03(5)(a).

318. *See* Horn, *supra* note 295.

319. *See* Julie L. Rogers et al., *Open Book Management and SRC*, 7 ACAD. STRATEGIC & ORGANIZATIONAL LEADERSHIP 11 (2002).

320. Khurana, *supra* note 8 at 28.

321. *See, e.g.*, Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921, 921–22 (1999); Donald C. Langevoort, *The Human Nature of Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 799 (2001) ("Current policymaking initiatives show an increasing tendency

Many who think independent directors lack expertise and company-specific knowledge and disrupt board chemistry may have an incomplete picture of ESF intermediation in the appointment and onboarding processes. ESF talent acquisition and services, such as audits and evaluations, can help corporate boards achieve desired levels of independence and expertise.[322]

2. *Diversity*

Some observers contend that ESFs do not simply bring parties together but become indispensable to many processes and shape labor markets.[323] If so, even to a limited extent, they have the potential to respond to client, industry, and regulator calls for diversity at the highest levels of today's domestic and multinational corporations.[324]

Some scholars contend that ESFs disproportionally favor executives from large, high-performing organizations over underrepresented nonwhite applicants, women, and applicants with certain skill sets.[325] They further contend that ESFs take a conservative approach targeting "defendable" candidates.[326] Even if these claims are true, the responsibility for diversity ultimately rests with the board.[327] If boards mandate that ESFs find diverse candidates, they will most likely deliver. The board gives the ESF its mandate to conduct the search, plays a central role in defining the position specifications, and can restrict the scope of services the ESF provides.[328] Despite the ESF's influential gatekeeping role, the

to assume the benefits of director independence and accountability, and hence the self-evident desirability of legal reforms to promote them."); Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 449–50 (2008).

322. *See* Bhagat & Black, *supra* note 321, at 954–55.

323. TOMÁS MARTINEZ, THE HUMAN MARKETPLACE: AN EXAMINATION OF PRIVATE EMPLOYMENT AGENCIES 1–2 (1976).

324. *See, e.g.*, Vanessa Fuhrmans, *California Becomes First State to Mandate Female Board Directors*, WALL STREET J. (Sept. 30, 2018, 6:13 PM), https://www.wsj.com/articles/california-becomes-first-state-to-mandate-female-board-directors-1538341932.

325. DOLDOR ET AL., *supra* note 8, at 28 ("[F]irms tended to target large, reputable, high-performing companies, so individual executives were more likely to be on the list of the search firm if they already worked in well known organizations. . . . Similarly . . . search firms tend to focus on a narrow and highly visible pool of executives, paying more attention to the prestige of the organisations in which these candidates hold roles. . . ."); *see* Adams et al., *supra* note 8, at 209; Cappelli & Hamori, *Understanding Executive Job Search*, *supra* note 8, at 1524; Meriliainen et al., *supra* note 8, at 5–6; Michelman, *supra* note 8, at 1.

326. Cappelli & Hamori, *Understanding Executive Job Search*, *supra* note 8, at 1524.

327. *See* Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 SMU L. REV. 299, 310–11 (2009) ("The board is ultimately responsible for hiring the CEO, (footnote omitted) often with the assistance of an executive search firm.") (footnote omitted).

328. *See* Adams et al., *supra* note 8, at 211.

board's involvement and receptiveness remain the drivers in diversifying CEO and director positions.[329]

Diversity and inclusion efforts are contextually determined.[330] Executive searches characterized by significant board engagement and an ESF that provides access to a wide pool of candidates are more likely to yield diverse candidates.[331] Some observers contend that diversity efforts should target both board members and C-suite executives, noting that while some boards have become more diverse in recent years, the C-suite has not.[332] Directors often come from the ranks of former senior executives.[333] Studies find a myriad of reasons for the persistence of homogenous boards, including: (i) the processes through which they select new members; (ii) preference for current or former CEOs; (iii) entrenchment; and (iv) attitudes that define their corporate culture.[334]

A hiring board's culture is likely to reflect its receptiveness to diversity.[335] Even if it uses an ESF, a board firmly committed to the status quo is unlikely to require diverse candidates.[336] Some boards may not prioritize diversity unless activist shareholders and stakeholders exert pressure.[337] Currently, socially conscious investors are using environmental, social, and governance ("ESG")

329. *Id.*

330. *See id.* at 209 ("Gender diversification on corporate boards is likely to be higher when searches are inclusive and active, both of which are in the hands of the board.").

331. *See id.* at 209–10.

332. *See id.* at 210 ("[Reactionary boards] are likely to cull candidates from a relatively narrow range of experiences and backgrounds, favoring, in particular, current or former CEOs.").

333. *See id.*

334. *See* DOLDOR ET AL., *supra* note 8, at 35 ("Research on corporate directors suggest that there is significant social cohesion among the 'inner circle' of the corporate elite, formed by corporate Board directors, CEOs and Chairmen (citation deleted). The social cohesion of the inner circle has been attributed to high levels of demographic homogeneity, common social ties, shared attitudes and similar ways of behaving. . . . [P]ersistent norms of conduct for directors can ultimately be traced to director-selection processes that tend to restrict entry into the corporate elite to demographically similar individuals . . . .").

335. *See id.* at 11–12 ("[E]vidence suggests that broader cultural factors (cultural norms and values, political systems, gender equality trends in the labor market) have an impact not only the proportion of women on Boards, but also on the measures taken to increase it.").

336. *See* Adams et al., *supra* note 8, at 210 (describing "oblivious boards" as boards that "tend not to be opposed to diversity in the boardroom and the executive suite, but board composition is not a high priority, and directors have not embraced practices to become more diverse." These boards are comprised of "'older' possibly retired, individuals with relatively little contact with the changing business world.").

337. *See id.* at 209–10 ("Exposure to possible negative publicity or action by shareholders or institutional investors unhappy with all-male boards also may motivate change."). Moreover, there are available resources identifying candidates such as CalPERS' and CalSTRS' Diverse Director Data Source ("3D"). *Id.* at 208.

criteria to screen a company's operations and potential investments. ESFs can help boards respond to an array of shareholder and broader stakeholder demands for greater diversity.[338]

B. Executive Pay

Although scholars have extensively explored executive pay and the role of compensation consultants, they have ignored the important role of ESFs in salary negotiations.[339] The salaries of public company CEOs are often disclosed and well known, which may not be the case for private companies.[340] Acquiring the services of a sitting external CEO can be expensive for both the hiring company and the candidate. The hiring company must be prepared to "buy the candidate out" of the existing executive services agreement, which can ratchet up executive pay.[341] Moreover, ESFs often require a significant percentage—perhaps a third—of the hiree's total first-year salary as compensation.[342] For some industries, these consultant fees are in the millions of dollars. Thus, ESFs are necessarily attuned to executive-compensation transactions.[343]

In short, external searches for CEOs often are more expensive than promoting internal candidates.[344] Some observers contend that lucrative fees drive ESFs to promote a modern-day myth of the external corporate savior.[345] Although rent-seeking incentives are present, most global ESFs now provide succession-planning services that assist companies in developing and preparing internal talent.[346] One top consultant asserted that in today's environment, consistently seeking external candidates may signal the organization's internal failure.[347] ESFs are positioned to address both external and internal labor markets. Their lines of business are steadily diversifying, with

338. *See id.* at 209.

339. *See* Discussion with senior ESF Professional (Dec. 2, 2018).

340. *See* Simmons, *supra* note 327, at 342–43 ("In 2006, the SEC adopted new regulations prescribing more extensive requirements for disclosure of executive compensation. . . . Companies must disclose compensation for their top five executives in their annual disclosure documents and include a detailed compensation discussion and analysis (CD&A).").

341. *See id.* at 311 ("The market for top executives is extremely competitive, resembling free-agency in professional sports. Companies are likely to pay even more to secure external CEO candidates during periods of economic turmoil because candidates are reluctant to move and desire greater compensation in exchange for additional risk associated with changing positions.") (footnote omitted).

342. *Id.* at 354 n.350.

343. *Id.*

344. *See* KHURANA, *supra* note 7 ("Globally, executive search is an $11.5 billion industry; more than half that revenue is generated in the United States, where search firms are used about four times more often than in Europe, where inter-firm mobility has remained relatively low.") (footnote omitted).

345. *See* KHURANA, *supra* note 7, at x.

346. YUCEL, *supra* note 85, at 11.

347. *See* Discussion with senior ESF Professional (Dec. 2, 2018).

talent acquisition generating a smaller proportion of revenues, although still much more than any of their other services.[348]

C. Robust Vetting

In the current ESG, "Me Too," and "Times Up" business environment, high-profile scandals caused by the personal misconduct of senior executives are a frequent topic of conversation among corporate directors, investors, scholars, policymakers, and the public.[349] Here, the use of ESFs takes on added importance from a legal, operational, and especially a reputational standpoint.[350] Arguably, more robust candidate vetting is needed to capture prior misconduct, integrity lapses, or conduct inconsistent with a corporate culture.[351]

Hypothetically, a high-performing CEO, meeting financial targets, could be hired, despite the board's awareness (or having reason to know) of past allegations of workplace misconduct (e.g., sexual misconduct). Suppose that after only a year on the new job, the CEO engages in similar workplace misconduct and is dismissed. The shareholders quickly sue the board for breach of fiduciary duty in hiring the CEO along with a corporate waste claim targeting a large severance package. If the board outsourced candidate vetting to an ESF, its reliance on experts, via § 141(e), would probably evidence good faith and fair dealing, fulfilling the duty of care and preserving deferential business judgment review.[352] Even in the face of past allegations and prior no-fault settlements involving allegations of sexual harassment, a board's exercise of its discretion in the hiring context is unlikely to be successfully challenged in court.[353]

Recent struggles at Uber over senior executives' workplace misconduct shed light on the subject of robust vetting by ESFs, especially for public companies and companies with public aspirations like Uber.[354] Following an extensive internal

348. YUCEL, *supra* note 85, at 11.

349. Trustees United, a coalition of long-term institutional investors controlling over $600 billion of assets, came together to establish principles in this area. *California Pension Trustees Call for Disclosures of #MeToo Costs*, NEWSMAX (Jan. 14 2019, 12:24 PM), https://www.newsmax.com/finance/personal-finance/california-pension-trustees-metoo/2019/01/14/id/898109/.

350. *See* Oliver Staley, *Headhunters Have a Much Harder Job in the Age of #MeToo*, QUARTZ AT WORK (Aug. 13, 2018), https://qz.com/work/1348376/headhunters-have-a-much-harder-job-in-the-age-of-me-too/.

351. *See id.*

352. *See* Simmons, *supra* note 327, at 339.

353. *See* discussion *infra* notes 352–62 and accompanying text.

354. Multiple reports involving misconduct by Google senior executives ranging from the creator of Android to the director of X unit at Google's parent Alphabet have attracted negative public attention. *See* Daisuke Wakabayashi, *Alphabet Executive Resigns After Harassment Accusation*, N.Y. TIMES (Oct. 30, 2018), https://www.nytimes.com/2018/10/30/technology/alphabet-executive-

investigation led by former United States Attorney General Eric Holder and the resulting report to the board of directors, Uber co-founder and CEO Travis Kalanick was removed, and a new CEO, Dara Khosrowshahi, was hired.[355] Notably, Uber retained an ESF to assist in the search.[356] Although the process is often kept confidential, Khosrowshahi emerged from a slate of high-profile candidates due in part to many competencies the previous CEO lacked.[357] Clearly, some form of vetting on socio-cultural questions was necessary.[358] Since joining Uber, Khosrowshahi has aggressively rebuilt its senior team and attempted to reboot the company's reputation among stakeholders.[359] His mission is not moral but a calculated business strategy: purging the company of its toxic cultures and building its immune system by hiring all-star legal talent inter alia.[360]

The recent scandals at Uber and other Silicon Valley companies illustrate how the patina of innovation and the rhetoric of virtue may obfuscate abuse and dysfunction. In the face of misconduct, the once limited critique of the aggressive growth practices and "regulatory

sexual-harassment-resigns.html?action=click&module=Well&pgtype =Homepage&section=Technology; Daisuke Wakabayashi & Katie Benner, *How Google Protected Andy Rubin, the 'Father of Android'*, N.Y. TIMES (Oct. 25, 2018), https://www.nytimes.com/2018/10/25/technology/google-sexual-harassment-andy-rubin.html?module=inline; Daisuke Wakabayashi & Kate Conger, *Google Workers Fume Over Executives' Payouts After Sexual Harassment Claims*, N.Y. TIMES (Oct. 26, 2018), https://www.nytimes.com/2018/10/26/technology/sexual-harassment-google.html?action=click&module=RelatedCoverage&pgtype =Article&region=Footer.

355. Sheelah Kolhatkar, *At Uber, A New C.E.O. Shifts Gears*, NEW YORKER (Mar. 30, 2018), https://www.newyorker.com/magazine/2018/04/09/at-uber-a-new-ceo-shifts-gears.

356. Biz Carson, *Uber Has Hired Recruiting Giant Heidrick & Struggles to Find a Sidekick for Embattled CEO Travis Kalanick*, BUSINESS INSIDER (Mar. 9, 2017, 7:51 PM), https://www.businessinsider.com/uber-hires-heidrick-and-struggles-for-coo-search-2017-3.

357. *See* Kolhatkar, *supra* note 355.

358. *See id.*

359. *See id.*

360. *See generally* Omari Scott Simmons, *The Corporate Immune System: Governance from the Inside Out*, 2013 U. ILL. L. REV. 1131 (2013) (discussing the prescription approaches to reforming corporate governance). A recent *New Yorker* article describes the dilemma Uber faces:

> The dramatic decline of Uber's reputation has shaken Silicon Valley, which likes to think of itself as a force for good, even when confronted with evidence to the contrary. "Nick Beim, a partner at the venture-capital firm Venrock, told me, 'This particular company was so far out on the spectrum. It has cast such a shadow over Silicon Valley.' At the same time, Uber's continued financial success has reinforced the idea that ruthlessness will be rewarded. 'Is it O.K. to condone unethical behavior if you make a lot of money?' Beim asked. "It shouldn't be, but that's the looming question Silicon Valley needs to take a stand on."

Kolhatkar, *supra* note 355.

entrepreneurship" of technology companies has yielded to increasing skepticism.[361]

Top-down leadership of boards and CEOs is viewed as critical to preventing and handling workplace harassment, ESG, and other concerns.[362] A talent-acquisition process that screens for these competencies is a prudent approach to preserve corporate value.[363] In this context, vetting by ESF intermediaries is an important mechanism to address corporate risks.[364] The efficacy and value of ESFs partly hinges on their ability to design and execute a search process that thoroughly vets candidates in a legal, confidential, and ethical manner.

D. Board Evaluation

Board evaluations are now considered a best practice in promoting good governance.[365] NYSE listing standards mandate that the board and its principal committees conduct an annual self-assessment.[366] Moreover, SEC rules require companies to disclose "the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director."[367] Institutional investors are also demanding greater disclosure of the board-evaluation process.[368] Increasingly, boards are considering whether their present members and candidates for membership have the right skill sets and attributes to achieve the corporate mission.[369]

Evaluations can address the entire board, a committee, or an individual member.[370] Companies are generally free to choose the procedures and criteria to determine performance.[371] The nominating/governance committee normally supervises the process, but it can also be conducted by the full board, another committee, or a third party, like an ESF.[372] ESFs can play an important role in

361. Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. 383, 391–92 (2017).

362. Press Release, U.S. Equal Emp't and Opportunity Comm'n, Holistic Approach Needed to Change Workplace Culture to Prevent Harassment, Experts Tells EEOC (Oct. 31, 2018), https://www.eeoc.gov/eeoc/newsroom/release/10-31-18.cfm.

363. *See* KHURANA, *supra* note 7, at 116.

364. *See id.*

365. *See* NYSE LISTED COMPANY MANUAL §§ 303A.04(b)(ii), 303A.05(b)(ii), 303A.07(c)(ii) (2013).

366. *See id.*

367. *See* Directors, Executive Officers, Promoters and Control Persons (Item 401), 17 C.F.R. § 229.401(e) (2018).

368. *See* COUNCIL OF INSTITUTIONAL INV'RS, BEST DISCLOSURE: BOARD EVALUATION 2–4 (Sept. 2014), https://www.cii.org/files/publications/governance_basics/08_18_14_Best_Disclosure_Board_Evaluation_FINAL.pdf.

369. Lamm, *supra* note 1, § 7.04 at 7-26–29.

370. *Id.*

371. *Id.* § 7.04 at 7-26.

372. *Id.*

facilitating the evaluation process on a periodic basis. These evaluations could be used to reveal the need for improvements, such as ensuring better information flow to the board.[373] Acting as third-party facilitators, ESFs can also preserve anonymity during the evaluation process if the board decides it is necessary or desirable.[374]

E. Succession Planning

Corporate law gives the board the responsibility and authority to hire a CEO.[375] By extension, it is responsible for succession planning that is critical for sustained performance, governance, and continuity of operations.[376] Succession planning complements and often follows the CEO/senior management evaluation processes. It can be used to weed out poorly performing managers and ensure that internal talent is nurtured and cultivated.[377] The process should include the periodic identification of the attributes and skills of an effective CEO and other senior management positions. Generally, it falls into two categories: (i) long-term (e.g., facilitating the grooming of internal candidates for promotion); and (ii) short-term (e.g., preparing for sudden departures due to illness or emergencies).[378]

Succession planning may be the board's responsibility, but in practice, its execution presents some challenges. A study of CEO succession found that a company will perform better under a CEO hired from within rather than under an external hire.[379] This superior performance coinciding with a CEO chosen from within the company applies whether or not a company has performed well in the past.[380] And the greater effectiveness of internally sourced CEOs is likely attributable to their insider knowledge of the company's operations, competitors, capabilities, culture, and other factors.[381]

---

373. *Id.* § 7.04 at 7-27.

374. *Id.*

375. *See* DEL. CODE ANN. tit 8, § 141(c) (2017).

376. Haas, *supra* note 278, § 4.01; NYSE LISTED COMPANY MANUAL § 303A.09 (2013) (including additional commentary); *see also* BUS. ROUNDTABLE, THE NOMINATING PROCESS AND CORPORATE GOVERNANCE COMMITTEES: PRINCIPLES AND COMMENTARY 12 (Apr. 2004), https://s3.amazonaws.com/brt.org/archive/Business%20Roundtable%20Nominating%20Committee%20Principles.pdf; BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE 23 (Aug. 2016), https://s3.amazonaws.com/brt.org/Principles-of-Corporate-Governance-2016.pdf; SEC Staff Legal Bulletin No. 14E (Oct. 27, 2009) https://www.sec.gov/interps/legal/cfslb14e.htm.

377. Haas, *supra* note 278, § 4.02.

378. Lamm, *supra* note 1, § 7.05 at 7-29.

379. Joseph L. Bower, *Managing Your CEO's Succession: The Challenge Facing Your Board*, *in* THE FUTURE OF BOARDS: MEETING THE GOVERNANCE CHALLENGES OF THE TWENTY-FIRST CENTURY 53, 54–56 (Jay W. Lorsch ed., 2012).

380. *Id.*

381. Boris Groysberg et al., *Are Leaders Portable?*, HARV. BUS. REV. (May 2006), https://hbr.org/2006/05/are-leaders-portable.

However, in an age of high CEO turnover, underperforming companies tend to seek external CEOs, usually enlisting ESF services.[382] Several reasons explain this trend: the CEO job is extremely difficult; the process of developing internal successors is time intensive; and the board is under a great deal of pressure to make a defensible choice.[383] A corporate board that meets infrequently and includes independent directors may lack the overall insider knowledge and familiarity with internal employees.[384] The current CEO and incumbent management may be responsible for succession planning, but they may not create the growth opportunities that allow senior executives to broaden their competencies.[385] High-performing inside candidates may lack the vision to run the entire company because they have not been properly challenged with strategic assignments.[386] Succession planning puts CEOs in the awkward position of identifying and developing their successor, and some, concerned largely with self-preservation, may value loyalty above competence.[387]

In any case, a dearth of well-prepared talent resulting from poor succession planning threatens corporate performance and sustainability.[388] An organization that does not develop internal talent or identify and prepare internal successors to step in as soon as the CEO departs has in a sense failed.[389] Removing a CEO is difficult if the board is not sure that potential internal successors are qualified. Boards should require CEOs to demonstrate their talent-development efforts and create a corporate continuity-of-operations plan ("COOP").[390]

Consequently, subject to resource restraints, a board can engage an ESF for assistance in evaluating internal and external candidates.[391] A leading ESF's recommendation of an external candidate may carry considerable weight in terms of defensibility,[392] even though this executive may lack an understanding of the hiring company's culture and the internal actors (e.g., employees) who can drive change.[393] Nonetheless, with the increased emphasis on succession planning and the difficulties it presents boards and CEOs, ESF services continue to be in high demand.

382. Bower, *supra* note 379, at 55.
383. *Id.* at 56.
384. William George, *Board Governance Depends on Where You Sit*, *in* THE FUTURE OF BOARDS: MEETING THE GOVERNANCE CHALLENGES OF THE TWENTY-FIRST CENTURY 97, 99 (Jay W. Lorsch ed., 2012).
385. *See* Bower, *supra* note 379 at 65.
386. *Id.* at 61.
387. *See id.* at 60–61.
388. *Id.* at 60.
389. *Id.* at 72.
390. *See id.* at 64, 72–73.
391. *Id.* at 64.
392. *Id.* at 64–65.
393. *Id.*

VII. CRITIQUES OF ESFS

Corporate governance is inevitably a function of environmental factors and individual actions. At a minimum, the influence of ESFs illustrates that talent matters.[394] Although ESFs do not formally choose candidates, they provide the structure and frameworks by which CEO and board candidates are vetted and selected. In this sense, ESFs are major players in modern corporate governance. This prominent role demands examination and critique. From a business perspective, procuring outside ESF services has potential disadvantages and costs.[395] Many external procurement problems stem from information asymmetries between the client corporation and the outside service provider.[396]

A. Credence Services

Client corporations are vulnerable to opportunistic ESFs seeking to extract higher profits or rents.[397] First identified by professors Michael Darby and Edi Karni, *credence services*, such as automobile repairs and certain medical, educational, legal, and consulting services, are those whose quality cannot be fully determined even after the search process and consumption.[398] Credence services have "high pre-buying costs and high post-buying costs of quality

394. Talent is inevitably circumscribed by environmental factors. A poorly performing company can have excellent individual talent but have a poor internal culture and suffer from a difficult market. While acknowledging that both individual talent and environmental factors influence corporate performance, measuring their respective weight is a difficult exercise. *Id.*

395. Oliver Williamson asserts that the internal organization of procurement services as a market substitute yields significant advantages, which fall into three categories: (i) incentives, (ii) controls, and (iii) structural advantages. *See* Williamson, *Vertical*, *supra* note 55, at 113–14.

396. Gilson, *supra* note 282, at 889 ("The most distinctive characteristic of the demand side of the market for legal services is pervasive information asymmetry concerning product quality.").

397. *See* Victor Fleisher, *Brand New Deal: The Branding Effect of Corporate Deal Structures*, 104 MICH. L. REV. 1581, 1600 (2006) (listing the three types of goods: (i) search goods, (ii) experience goods, and (iii) credence goods). The quality of search goods, such as clothing, footwear, and jewelry, can readily be discerned during the search process prior to consumption. *See id.* Search goods have "low pre-buying costs of quality detection." MEN-ANDRI BENZ, STRATEGIES IN MARKETS FOR EXPERIENCE AND CREDENCE GOODS 2 (2007); *see also* Philip Nelson, *Information and Consumer Behavior*, 78 J. POL. ECON. 311, 327 (1970) (analyzing consumer behavior with respect to search and experience goods). On the other hand, the quality of experience goods is not discerned during the search process but rather after consumption. *See* Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67, 68 (1973). Experience goods have "high pre-buying costs of quality detection," but low post-buying costs. BENZ, *supra* note 397, at 2. Examples of experience goods include jobs, movies, newspapers, wine, and food. *Id.*

398. *See* Darby & Karni, *supra* note 397, at 68–69 ("Credence qualities are those which, although worthwhile, cannot be evaluated in normal use.").

detection."[399] Buyers' ability to assess the service's value is hampered by the asymmetry of their knowledge compared to the seller's information advantages.[400] In this context, determining ESF service value will either be impossible or expensive.[401] The lapse of a considerable period of time may also reveal the value of the service.[402]

Two types of knowledge asymmetry are implicated in credence services: customers' inability (i) to know their needs or diagnose their problems and (ii) to determine the level of service necessary.[403] The interplay between diagnosis and service exacerbates the dilemma because "consumer ignorance and [the] additional cost of separate diagnosis and repair provide motivation for a service firm to defraud its customers."[404] Economist Oliver Williamson describes a similar *veracity risk*, when "information may be filtered and possibly distorted to the advantage of the [service] firm that has assumed the information collection responsibility."[405]

These dynamics apply to the ESF context. Consider the following example: a company can take option X—that is, perform an internal and external CEO search using its own HR resources—or option Y—rely on an ESF to assist in filling the opening.[406] Assume the company takes option Y, and the ESF implements a particular search strategy and structure to yield the ideal candidate. Would the internal HR resources have yielded an acceptable candidate and avoided the significant ESF consulting fees? Because ESF services involve questions of judgment against a backdrop of uncertainty, the client must depend on it, not only to provide services, but to determine the adequate level of service, including the strategy, structure, and parameters of the search.[407] Option Y is more costly than option X,[408]

399. BENZ, *supra* note 397, at 2.
400. *Id.*
401. *Id.*
402. *See id.*
403. *See* Brian Roe & Ian Sheldon, *Credence Good Labeling: The Efficiency and Distributional Implications of Several Policy Approaches*, 89 AM. J. AGRIC. ECON. 1020, 1020 n.1 (2007) ("[O]nly an expert can diagnose the consumer's true needs, e.g., does the car need a minor or major repair? And only the seller may know the level of service actually provided, e.g., was the car given the appropriate level of service?").
404. Darby & Karni, *supra* note 397, at 77.
405. Williamson, *Vertical*, *supra* note 55, at 120.
406. KHURANA, *supra* note 7, at 92–93, 119–20.
407. *Id.* at 118–19.
408. *Cf.* Gilson, *supra* note 282, at 902–03 n.73. Gilson explains how a corporation can generally save money by internalizing legal services instead of hiring outside counsel:

> As Robert Mnookin and I stated four years ago, "[g]eneral counsel for major corporations are creating a revolution and are the primary agents of change." Increasingly, general counsel are former partners in large corporate firms who are capable of internalizing both the diagnostic and referral functions they previously performed on behalf of clients as outside counsel. The critical difference is that internalizing these

and credence characteristics—that is, information asymmetries caused by the coupling of diagnostic and service functions within an ESF—enhance the likelihood of ESF opportunism. Without an HR department with executive search expertise or directors with relevant search experience, the corporate client is not necessarily a sophisticated purchaser of ESF services.[409]

Despite the potential for increased costs, large companies routinely engage ESFs to fill top positions.[410] Some observers contend that ESFs opportunistically profit from the myth of the charismatic external savior; studies find the link between CEO selection and long-term growth inconclusive.[411] Additionally, they suggest that to increase demand for their services, ESFs promote discourses of complexity and employ scare tactics to convince companies that they need external executive talent.[412] The following passage captures this critique:

> Headhunters claim to be the only people with the high-levels of expertise needed to find talent, something that produces a new and powerful logic that informs recruitment practices. As potential clients seem to have accepted this logic and have become enrolled into the idea that headhunters are the only way to recruit executives, search firms have developed powerful positions in executive labour markets. Using this as a starting point, firms then use the various 'technologies' at their disposal as resources to further consolidate this position.[413]

In the interest of balance, this critique does not necessarily reflect the current thinking and practice of ESFs who assist

> functions eliminates the information asymmetry between client and lawyer, so that no relationship specific assets are created and no lock-in effect results. The consequence is a dramatic reduction in the switching costs facing clients and an elimination of lawyer's market power.

Id. (quoting Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313, 381 (1985)).

409. *Id.* at 889 ("The most distinctive characteristic of the demand side of the market for legal services is pervasive information asymmetry concerning product quality.").

410. KHURANA, *supra* note 7, at 120 ("Globally, executive search is an $11.5 billion industry.").

411. *Id.* at 26; *see generally* Tom C.W. Lin, *CEOs and Presidents*, 47 U.C. DAVIS L. REV. 1351 (2014) (describing several common problems that often cause CEOs to harm the economic growth of their respective corporations, even if the CEOs were carefully selected).

412. Faulconbridge et al., *supra* note 8, at 803 ("One of the most important strategies of executive search firms has been the use and proliferation of the types of discourses outlined at the start of the paper. Promoting the idea that talent is scarce yet essential in order to maximise profitability has allowed headhunters to effectively 'scare' firms into seeking support in the recruitment of executives.").

413. *Id.* at 804.

companies with succession planning and cultivating a pipeline of potential internal candidates.[414] However, viewing external searches as costless and always optimal is shortsighted.[415] Overreliance on external candidates may signal a lack of mobility and development opportunities within an organization and lower the commitment of senior employees.[416] It also adds the expense of buying the external candidate out of an existing employer contract.[417]

B. Switching Costs

Another potential drawback to procuring outside ESF services stems from the high switching costs that result when a corporate client becomes overly reliant on a single firm.[418] A company's relationship with one ESF yields client-specific assets and knowledge that can be reused; hiring another ESF would mean recreating them and duplicating some costs. In fact, the high cost of switching gives ESFs additional bargaining power, and the corporate client may have to endure unresponsiveness and inferior service.[419] To the extent that client-specific knowledge is not costly to generate and the five largest ESFs are viewed as interchangeable, companies can more easily change providers because switching costs are low.[420] However, the more services beyond talent acquisition an ESF provides to a client, the less likely companies are to switch and incur the additional costs.[421] In response to credence and switching costs, corporations might increase investment in their HR functions to both perform and procure talent-acquisition services in the marketplace.[422]

---

414. *See, e.g.*, *Board & CEO Services*, *supra* note 87.
415. Bower, *supra* note 379, at 65.
416. Faulconbridge et al., *supra* note 8, at 801.
417. KHURANA, *supra* note 7, at 184.
418. Gilson, *supra* note 282, at 900 ("[A] pattern of practice developed that led to long-term lawyer-client relationships and full-service law firms. The result was that switching lawyers was costly to a client."); *see also* Robert Eli Rosen, *The Inside Counsel Movement, Professional Judgment and Organizational Representation*, 64 IND. L.J. 479, 508 (1989) ("The delivery of legal services requires and creates client-specific assets. When these assets are developed by an outside counsel, the corporation can capture them by rehiring the lawyer or firm.").
419. Rosen, *supra* note 418, at 508, 510–11.
420. *See generally id.* at 507–08 (describing how the high price of routine legal work conducted by elite private firms may cause corporations to move this type of legal work to other providers).
421. *See generally id.* at 509 (explaining that a corporation is unlikely to switch legal service providers when the legal work it requires is non-routine, innovative, or based on specialized knowledge).
422. Abram Chayes & Antonia H. Chayes, *Corporate Counsel and the Elite Law Firm*, 37 STAN. L. REV. 277, 277–78 (1985) ("[T]he decision whether to retain outside counsel or handle the issue inside—the 'make or buy' decision—is made by the general counsel.").

C. Oligopoly-Related Issues

The ESF market for CEOs and directors is oligopolistic in nature with a small number of firms with high barriers to entry. ESFs operate in a competitive oligopoly where dominant ESF are less likely to engage in aggressive price competition and more likely to compete through product or service differentiation. Notwithstanding, a scenario could arise where the ESF market reflects the perils associated with other oligopolistic markets—limited competition, conflicts, and misaligned incentives. Aligning ESF incentives and limiting conflicts should remain an ongoing concern for ESFs, client corporations, and regulators. Generally, ESFs are compensated upon completion of an executive search. Yet post-search accountability for ESFs seems limited beyond reputational risks. This issue, however, impacts many professional service providers and is not unique to ESFs. Conceivably, there are mutually beneficial alternative fee arrangements that might better capture the upside benefits and downside risks of hiring. This experimentation with alternative fee structures has been explored in the legal service provider context.

D. Creating a "New Boy's" Network

Critical observers assert that "in order to be successful in elite labour markets candidates need to be known [and connected] to search consultants."[423] They contend that ESFs have actually reproduced elite hierarchies rather than dismantled them.[424] Specifically, they argue that a "new boys'" network has been perpetuated by ESF networks that favor candidates with similar elite educational, class, and professional markers.[425] Observers explain this phenomenon:

> Rather it means that headhunters primarily utilise the 'new boys' networks which consists of a new elite and preferred stratum of candidates who dominate in labour markets at the expense of those not fitting the model. This 'new' network includes women, is international in composition but maintains many of the class and social status markers of the 'old boys' network'. Consequently, individuals with the right (geographical) biographies gain powerful, dominant positions in elite labour markets leaving those less-than ideal-type candidates poorly placed to compete in what, according to the rhetoric, are open, talent-defined and fluid elite labour markets in the contemporary knowledge economy.[426]

423. Faulconbridge et al., *supra* note 8, at 802.
424. *Id.* at 803. ("Yet our research suggests that hierarchical, restrictive network practices have actually been reproduced in contemporary elite labour markets because of the way executive search firms operate.").
425. *Id.* at 803.
426. *Id.* at 806.

Critics maintain that even with ESF engagement, elite executive recruitment remains a restrictive and closed system rather than a fluid and open process.[427]

E. Sidestepping Responsibility

Critics contend that ESFs allow boards to sidestep responsibility for poor hiring decisions.[428] Stated differently, the use of an ESF is a best practice and widely considered a prudent risk-mitigating approach for high-profile hires in large corporations. The stakes behind CEO and director hires are extremely high. A poor hire may lead to scandal, share-price decline, and top employee defection to other companies.[429] Directors wish for stakeholders to perceive them as diligent, deliberative, and procedurally fair.[430] Engaging a reputable ESF to manage the hiring process suggests that directors have exercised sound business judgment. Bringing in a third party also creates a perception of shared accountability, even though the directors are ultimately responsible.[431]

VIII. CONCLUSION

Board reliance on experts or gatekeepers is a central feature of modern corporate governance.[432] Yet, this story is incomplete without a consideration of ESF gatekeeping and intermediation. As activist investors and other stakeholders demand corporate governance reforms, ESFs are developing a menu of private solutions. Their foray beyond traditional talent acquisition into governance-related services, such as managerial and board assessments, reflect this trend.[433] ESFs offering a range of services now compete with other major professional service firms that provide board-related services, raising interesting questions for the future of corporate governance. Often beyond the reach of law, the efficacy of ESFs' private solutions to address a range of governance concerns merits further exploration by scholars, client corporations, and policymakers.[434]

427. *Id.* at 803.
428. KHURANA, *supra* note 7, at 148–49.
429. Faulconbridge et al., *supra* note 8, at 804.
430. *Id.*
431. Bower, *supra* note 379, at 64–65.
432. Lamm, *supra* note 1, § 7.01[1].
433. Shawn Parr, *Don't Let Culture Vultures Scuttle Your Strategy*, FASTCOMPANY (Feb. 29, 2012), https://www.fastcompany.com/1821579/dont-let-culture-vultures-scuttle-your-strategy.
434. The role of private ordering looms large across many discussions of regulatory design. Current trends in practice and law point toward new governance and private ordering approaches. *See* Lisa Blomgren Bingham, *The Next Generation of Administrative Law: Building the Legal Infrastructure for Collaborative Governance*, 2010 WIS. L. REV. 297 (2010); Gráinne de Búrca, *New Governance and Experimentalism: An Introduction*, 2010 WIS. L. REV. 227 (2010); Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance*

in Contemporary Legal Thought, 89 MINN. L. REV. 342 (2004). These trends raise an important question: Is firm private ordering inferior or superior to externally imposed, mandatory rules? Ultimately, this question is empirical, often dependent on context, and ripe for future exploration. *See* Scott Hirst, *Social Responsibility Resolutions*, 43 J. CORP. L. 217 (2017). Other important questions for further research include: Who should bear the responsibility for managing corporate governance risks? Is it the public through regulation, or does the private sector via private ordering assume responsibility for managing risks? Does shared responsibility fall somewhere along a private-public continuum?