Part I

Leadership in Your Boardroom

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Leadership: The Key to Effective Boards

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At a board meeting in 1993, the CEO and chairman of a mid-cap-listed company surprised his fellow board members by announcing that he had just agreed to sell the company to a larger competitor at the current share price. The announcement was stunning, not only because it was a complete surprise, but also because the CEO/chairman and his immediate family owned just over 50 percent of the company's shares. After the announcement, there was a shocked silence in the boardroom.

During this hiatus, the eyes of two of the six independent directors met. These two were not only the chairs of two of the board's committees (audit and governance) but also two of its most respected members—its leaders. On numerous previous occasions, they had earned the respect of the other directors by speaking out on issues that concerned them. Their interventions were usually thoughtful and well timed to affect the direction of the board's discussions. On this occasion, one after the other, they pointed out to their fellow directors that such a transaction, although it might appeal to the CEO/chairman, was not necessarily in the interests of the company's other shareholders. Using different language but making the same argument, they pointed out that the company's share price was near its low for the past two years, and that the company's strategic plan projected considerable growth in revenues and profits over the next few years.

The CEO/chairman responded that this was a deal that he and his family wanted done. They wanted to diversify their investments, and he believed the price was adequate. Besides he reasoned that as the majority shareholders, he and his family could do as they pleased.

One of the two vocal leaders, who was a lawyer, pointed out in response that the board's duty was to all the shareholders, not just the majority. The chairman responded heatedly that if the board did not approve the deal he could remove all of them and select directors who would. The other director, who had spoken earlier, rejoined by pointing out that the CEO/chairman was a bit like the Grand Poobah in Gilbert and Sullivan's operetta *The Mikado*. He did wear many hats. It was true that as the major shareholder he could remove the board, although that could lead to a nasty and public fight if the board members chose to resist. Moreover it was also true that as CEO, he was subject to the judgment of the majority of the board. If the directors did not like the actions he was taking, they could fire him!

At this juncture, other independent directors began to speak in support of their more outspoken colleagues. As the debate continued, it became evident that the CEO/chairman was very concerned that if the decision were not approved at this meeting the deal might fall through. Nevertheless the two board leaders, supported by their colleagues, persevered. The directors argued for a delay in any decision, while an independent investment banker evaluated the transaction and offered a "fairness opinion" to the board. Concerned about the negative impact any public spat would have on the company's share price, the CEO/chairman eventually agreed to this proposal.

On the basis of the independent assessment, and after a number of specially called board meetings, the CEO/chairman and his fellow directors reached an agreement that the company should remain independent. Three years later, the company was acquired

by another larger company, at a substantial premium to its share price at the time of the original proposal.

This is one example from my twenty years of experience as a corporate director, scholar of, and consultant to corporate boards, which can be used to illustrate how I think about the leadership of boards. There are two related ways to consider the topic. First, boards can and should provide leadership of their managements and companies. As I have argued elsewhere recently, it is imperative that boards accept this aspect of their leadership role.[1] They cannot allow themselves to become totally absorbed in issues of regulatory and legal compliance, as important as they are. In this example, the directors prevented a "fire sale" of their company and eventually delivered much greater value to the company's shareholders.

The second aspect of board leadership that this example illustrates is who emerges as a board's leaders and why, as I have come to understand it. These two perspectives are interconnected. In this case, two directors proactively took on the company's CEO/chairman, and its major shareholder. In these discussions, they became the de facto leaders of the other board members. As I shall explain, becoming a boardroom leader is not just a matter of being given a title, whether it is board chair, lead director, or committee chair. Rather, gaining the mantle of leadership is a complex interaction between one's own actions and the perceptions of one's fellows around the board table. Certainly there are many boards in which the formally designated leaders are the only leaders. In my experience, however, the most effective boards are those in which other directors also emerge as active leaders. In fact, in my experience, the more leaders that a board has, the better.

How leadership emerges (and it is an emergent process) on a board has an impact on how well the board is able to exercise leadership over its management and company. If the board develops effective leaders, it will do better in interacting with its

management and reaching decisions with them to move the company forward. For example, it will be able to work together in complicated discussions and decisions about the company's future capital structure, or future competitive direction.

The Importance of Board Leadership

Corporate governance and boards of directors have become a hot topic during the past two decades. This is because of the decline of many great American companies during this period as well as the corporate scandals at the turn of the century. The criticism has been that boards should have been more effective in preventing both types of problems. For example, directors at Disney, General Motors, and Morgan Stanley have been criticized for failing to halt the decline of their companies, and boards at Enron, Tyco, and WorldCom, among others, were accused of failing to spot and prevent the misdeeds that sank their companies.

Because of these failures in some of America's boardrooms, we have seen new legislation (Sarbanes-Oxley) and new regulations from the Securities Exchange Commission and the stock exchanges, all aimed at making boards better governors. Further, there has been pressure on companies from certain investors, especially government and union pension funds and their surrogates (such as Institutional Shareholder Services), to improve board practices and procedures. From all of this has come an emerging consensus of what are best boardroom practices (see Figure 1.1). Although I have been among those proposing and supporting such practices, what I find striking about them is the absence of much attention to the topic of board leadership. I define board leadership as the emergence of directors who are willing and capable to influence their fellow directors to take needed actions.

It is of course true that there is an ongoing debate about what is the best leadership structure for American companies and their boards—separate chairperson and CEO, or combining the jobs

- As many independent directors as possible (for example, only one or two management directors)
- As small a board as possible (for example, ten members or more)
- Regular executive sessions (independent directors without management)
- Three required committees and others as needed (audit, compensation, and governance)
- Six or more board meetings annually, including one multiday strategic retreat
- Approval and monitoring of company strategy
- Oversight of management development and management succession
- Selection of CEO and approval of his or her compensation
- Annual performance review of CEO related to his or her compensation
- Compliance with the Sarbanes-Oxley Act
- Established retirement age for directors
- Annual evaluation of board functioning
- New director selection to fit board and company needs

Figure 1.1 Board Best Practices.

with one person holding both. But what is missed in this discussion is an emphasis on the actual leadership behavior I am discussing here. With the exception of a white paper commissioned by the National Association of Corporate Directors and the book *Corporate Boards: New Strategies for Adding Value at the Top*, I am unaware of any attention to the topic.[2]

Yet my experience convinces me that the presence or absence of effective leaders is critical in determining how well boards can carry out their responsibilities. In fact, as I demonstrate in the balance of this chapter, it is the most critical determinant. As important as it is when boards are focused on their normal duties of ensuring the ongoing performance of their corporation, it is even more significant when they must deal with an unexpected crisis. Successfully conducting both responsibilities is the criteria by which boards should be judged, because both can and do have an impact on the health of the company and therefore on its value to its shareholders. In the balance of this chapter, I shall explore three topics: (1) the unique characteristics of boards that provide challenges for their leaders, (2) how these challenges differ under

ordinary and extraordinary circumstances, and (3) the qualities effective board leaders must possess. I shall use several examples from my experience to illustrate these issues.

The Nature of Boards

Exercising leadership on a board is complicated by the very nature of boards. To start with, the directors come into the boardroom expecting to be treated as equals. This psychological expectation is rooted in a legal fact. In the laws of all fifty states, including Delaware (the state with the largest number of public incorporations), directors are jointly and severally responsible for all actions their board takes. Anyone who would exercise leadership—whether a formally designated leader or a director asserting himself to lead the board on a particular issue—who ignores the fact that directors expect to be treated as peers, does so at the risk of failing as a leader.

This belief in equality is reinforced by the fact that with very few exceptions independent directors (who constitute the vast majority on most U.S. boards) also have primary careers in which they are used to exercising leadership roles. They are, for example, CEOs or other senior business executives, or perhaps retired government officials. As a result, they enjoy high social status in their lives outside the boardroom, and they expect appropriate treatment within the inner sanctum of the board. As a consequence of these facts, it is not an exaggeration to draw a similarity between leading a board and leading a pack of alpha male dogs. I intend no insult to either species. It is just that this parallel exists and is one factor that makes boardroom leadership challenging. Because they have experience as leaders elsewhere, board members are also unlikely to be passive followers.

Due to this emphasis on equality, those with formal leadership roles have only limited power. In fact, they are usually chosen by a vote of the other directors, which further constrains

their power. Certainly the chair, lead director, and the several committee chairs are assigned specific responsibilities, and are treated with respect and deference by their fellow board members. Yet the occupants of these positions, if they are to be effective, have to recognize the norms of equality that pervade the boardroom and that their fellow directors put them in their positions of leadership. For example, every board or committee chair that I have observed at work is very receptive to adding a suggestion by even the newest director for an item to be placed on the relevant agenda. Similarly, requests for more information are rarely, if ever, refused either by management or the board's formally designated leadership.

As I have argued earlier, small boards seem to work more effectively than larger ones.[3] In essence, it is a psychological fact that the fewer members a group has the easier it is for them to discuss issues and reach a consensus. But even a small board of say nine or ten independent directors, who expect to be treated as peers, can be difficult to lead. For example, a chair of such a board has the unenviable task of keeping the group focused on the topics listed on the agenda, and doing this in a specified and usually limited meeting time. It is not surprising that many chairs complain that they become so focused on the facilitation of the meeting that they find it hard to express their own views on the substance of issues.

The work of boards is characterized by two other factors that create leadership challenges. First is the timing of board meetings. For example, the typical American board holds six regular meetings a year, each of which usually starts late on an afternoon and continues for most of the next day. If there are matters that cannot be handled in the prescheduled meetings, or which arise between these meetings, special meetings are called to be held by telephone, or in person. It should also be noted that directors are very busy people, with complicated schedules, but the goal and expectation is to have all directors involved in every meeting.

Thus regular meetings are usually scheduled a year or more in advance, and special meetings are very difficult to arrange.

These time constraints create disjointed and truncated discussions. All directors, but especially those trying to assert leadership, face a challenge in remembering what has transpired in earlier discussions and therefore what actions they may wish to take in the next meeting. I have often seen management return at a board meeting to a complicated proposal that had been aired at the previous meeting, perhaps about a possible acquisition. Management is well versed in the details of the proposals. However, the non-executive directors, including the board's leaders, find themselves having to play catch-up on the details of the proposal, which can put them at a disadvantage both in leading their colleagues and in discussions with management.

The second complication confronting board leaders is even more daunting. Most board discussions do not take place just among the directors but also include members of management. A recent study by Katharina Pick reports that in the board meetings she observed, more than two-thirds of the interactions were between directors and managers rather than among the directors themselves.[4] Surprising as this may seem, it is not hard to explain. Most obviously independent directors depend on managers for information and knowledge about the company in general, and about the details of matters under discussion. Thus a significant purpose of many board meetings is to enable board members to understand their company better! Directors on well-functioning boards are provided with ample information in advance, but much of this relates to past company performance. Relying on it alone to make future-oriented decisions is like trying to drive a car by watching the rearview mirror. So it is not surprising that this much time in a typical board meeting is devoted to the directors learning about how management views the likely future of the company and the industry.

It is also true that a board must walk a fine line in its relationship with management. By now in most public companies, it is well accepted by the CEO and other senior executives that the board is the ultimate decision-making authority, legally and in reality. Yet management is the primary originator of most proposals that come before the board for discussion and decisions. After all, they have the knowledge and expertise to generate such ideas, and it is accepted that it is their task to do so. Further, it is the management team that will implement the decisions reached in the boardroom. Although directors may and do challenge management's proposals, they must do so in a manner that does not alienate senior executives. For those board leaders shaping the direction of the board's deliberation, this requires being sensitive to management's commitment to their proposals, even when the directors are critical of them. This is especially true because managers are so often in the boardroom during such discussions.

Even on the increasing number of occasions when directors hold such discussions in executive sessions, with no managers present, there is a need for sensitivity to management's feelings. Frank discussion among the directors alone is fine, but there is always the risk that openly critical remarks will get back to the management. Even if no such leaks occur, the board's leaders need to be mindful of how and by whom the board's conclusions will be communicated to their CEO and to other members of management. For example, I recall a board on which many directors were openly critical of the CEO in executive sessions. One or two directors took it upon themselves to talk to the CEO about these comments. These conversations were intended to be helpful, but they had the opposite result. The CEO became upset because he believed he had lost the confidence of the board.

All of the preceding characteristics of boards—a group of peers, leaders with limited power, time constraints, and a high dependence on management—shape the behavior required of

those who would be effective leaders, whether they are formally designated or whether they emerge. Obviously, they make leading boards a challenging task!

Leadership in Ordinary and Extraordinary Circumstances

One of the challenges facing boards, which is especially important, is the delicate relationship that directors must maintain with their management. This is especially true in the normal course of business, when there is no crisis. In essence, it is management's responsibility to shape proposals for the company's strategic future and to operate the company toward this end in accordance with existing laws and regulations. Top management also has the responsibility to ensure a pool of future management talent. The board's responsibility is to ensure that management is performing these responsibilities well and to approve major decisions. As suggested earlier, the challenge for a board's leaders is to accomplish the board's role, while keeping manager's heads and hearts in the game! If there are no unexpected problems, this is the essence of the board's leadership goals.

However, when crisis occurs, the board's job changes dramatically—especially when the crisis, as it often does, involves members of senior management. Suddenly the board and especially its leaders have a very different purpose—they must resolve the crisis themselves. In my experience, this is the toughest challenge that a board and especially its leaders can confront. This is the time when a board's leadership capability becomes most apparent.

I have reached this conclusion from two perspectives. First as a director who has experienced a number of such events, and second from having read and reviewed reports about and the testimony of the directors on the boards of Enron[5] and WorldCom[6] at the time of the scandals at those companies. In both instances, the

directors could and should have known that something was seriously wrong in their company. Yet no one on either board stepped up to take the lead in asking, Is something amiss? For example, the members of the audit committee of the Enron board were told by the Arthur Andersen auditors that the accounting methods being used, while acceptable, were "aggressive." Anderson suggested that the audit committee might seek a second opinion. None of the directors, including the committee's chair, who was a distinguished professor of accounting, chose to act on this advice. The only explanation for this failure that I can come to is that these directors had become so complacent because of their confidence in their top management that they believed management would do nothing improper.

In our recent book, my coauthor Colin Carter used the phrase "smell the smoke" to describe what directors must do to be certain that there is no fire underlying a whiff of something that seems not quite right.[7] What he was referring to was the need for directors to be alert to unusual events or data, and to maintain a certain skepticism about anything that seems amiss. Although I still believe this is an apt description of what directors must do under such circumstances, my own experience as a director involved with several different crises has led me to the conclusion that smelling the smoke is just the starting point for effective action in such situations. What is missing from too many boards is directors who are willing and able to take a leadership role when a whiff of smoke reveals that a conflagration has broken out.

Both in normal circumstances and in times of crisis, my definition of effective leadership is the same. As I have said, it entails having one or more directors who are willing to take the initiative to ensure that the board as a whole makes the right decisions and takes appropriate action. This means that board leaders must have the standing among their fellows as well as the will and ability to shape a consensus about the decisions and actions that need to be taken.

Examples of Boardroom Leadership in Crisis

I shall share a few examples of such leadership to provide a more thorough understanding of what effective board leadership involves. The first was described to my M.B.A. students by my former student and present colleague at Harvard Business School, Bill George, who when the events occurred in the 1990s was the chairman and CEO of Medtronic, Inc., a medical devices company. The second is derived from a teaching case about the American Express Company board in 1992.[8] The third is based on events at a company whose name and circumstances I have disguised.

In 1993, Bill George and his management team at Medtronic, Inc., brought a proposal to the board for the acquisition of a smaller medical devices company. This firm, like others Medtronic had acquired in the recent past, manufactured devices outside the company's original focus on cardiovascular medicine. Medtronic's strategy was to diversify the range of therapies for which it provided the health care industry medical devices.

The directors were well prepared for the discussion, which occurred at a regularly scheduled meeting, having reviewed a document prepared by management that described the transaction as well as the rationale for it. As the board discussion proceeded, various directors asked questions of George and his top managers present. In general the directors favored the proposal. There was one director, however, who expressed serious reservations about the acquisition. Even though he had a great deal of experience in health care and was articulate about his reservations, he was not successful in persuading any of the other directors about the validity of his arguments. To these other directors, management's argument seemed more compelling. After a couple of hours of discussion, the board gave the go ahead for the deal, with the one director abstaining. The board finished its other business, and the meeting was adjourned.

The next morning, George received a phone call from the dissident director, who lived several hundred miles from Medtronic headquarters in Minneapolis. He said he would like to fly back and spend some time talking with Bill about his concerns about the deal. Bill agreed, and they met a few days later. As a result of this discussion, George became convinced that the director had legitimate concerns, and agreed to reopen the discussion of the deal with the entire board. At a special meeting of the board, after reviewing the arguments for the deal and those presented by the lone director, it became clear to the other directors, as it had to Bill, that it was best to not move forward.

I have heard Bill describe these events to our students on several occasions. The lesson he draws from them is the importance of directors sticking with their beliefs, even if they are a minority of one. This is obviously one valid interpretation. However, for me, this is also an example of boardroom leadership. Too often I have watched a director, or even two or three, fold up their tent, and go along with the majority opinion, even though they had grave doubts about the merits of the proposed course of action. On this occasion, this director at Medtronic became a leader of the other board members, causing them to rethink what he considered a flawed decision. Incidentally, Bill says that had the original decision stood it could have cost the company many millions of dollars. So there can be real economic value to such leadership.

It is also interesting to reflect on how this director turned his concerns into proactive leadership. After losing the initial debate in the boardroom, he realized that he had to find support for his position. Recognizing that George was respected by the other directors, because of his successful leadership of the company, the director concluded that if he could convince the CEO, the other independent directors would be likely to follow. This illustrates well the point made earlier that management is almost always present in such board discussions. Directors who succeed as leaders need to be sensitive to this fact and to the nature of the

relationship between the CEO and the directors. Directors who try to assert leadership without understanding this relationship can create chaos, as my next example illustrates. Clearly one lesson for directors from such an event is to be willing to stand up for your ideas even as a minority of one. However, this example also illustrates that effective leadership in such circumstances involves finding allies who can enhance your influence.

There was tension in the American Express boardroom in November 1992. The longest-serving independent director, Rollie Warner, who was retiring in a few months, had asked to address the board without the CEO/chairman James Robinson's presence.[9] Robinson had agreed to the request, and after the regular pre-meeting dinner, he departed. Warner than stood up and made a presentation that was a severe indictment of Robinson's leadership of the company. In essence, he argued that Robinson had presided over the decline of the company and was personally responsible for a long list of problems, including decisions to acquire or to attempt to acquire many other financial services companies, which had been ill advised. The failure of the company's "financial super market strategy" should be laid at Robinson's feet and he should be asked to resign immediately was Warner's argument.

There were two serious flaws in Warner's attempt to assert leadership. First, many of his facts were wrong and exaggerated Robinson's culpability. Further, the board and Robinson had agreed on steps to remedy the company's actual problems, and these plans had been communicated publicly. Objective observers, including security analysts, reported that the company was making progress toward these goals. Warner's second failure was not understanding Robinson's relationship with other board members. Warner had discussed his concerns with three other board members, who he knew were critical of Robinson. However, the American Express board was large—eighteen directors—and included prominent CEOs and former cabinet officers, most of whom were supportive

of Robinson. After Warner delivered his diatribe, and the directors had absorbed the shock, a couple of Robinson's supporters were able to calm the waters sufficiently to work out a compromise. Robinson would stay for a few months and lead the search for his successor.

The lessons from this example seem clear. If you want to succeed as a leader in the boardroom, you better have your facts right and understand how your fellow directors will interpret them. Although this may seem obvious, it is more complicated than it seems. The facts underlying board discussions are often complex and subject to varying interpretations. Those who would lead also must count noses to understand how various directors interpret these facts. Because board members are usually so dependent on their CEO for their knowledge about the company, how they interpret these facts will obviously be related to how they feel about their chief executive and to their confidence in his performance. Successful board leaders need to understand these relationships! The implications for directors who want to be effective leaders are these. First, you need to stay focused on your director's role between board meetings. Even though you have a full time "day" job, you must continue to devote some of your attention to the boardroom issues between meetings. You cannot let the gaps between meetings dull your understanding of the company's issues. Second, you need to understand the company's CEO and other senior managers, and especially their capabilities, limitations, and biases. Finally, you need to understand the group dynamics of the board itself. Who are the other influential directors? What are their thoughts on the issues at hand? Who listens to them and to whom do they listen? In the end an important source of influences you have to become a board leader is the understanding that you demonstrate of the company's issues, and the alliances that you can establish with other directors to move the ball forward.

All of this is very well illustrated by the situation faced by the directors of a large diversified company at the beginning of this

century. Their problems began with an outcry from some institutional shareholders that the CEO/chairman was given a huge compensation package as the company's performance was slipping. A few months later, there were allegations by class action plaintiffs that the company had engaged in improper accounting practices. These events cast a cloud over the company's board and governance, from the perspective of the media and some shareholders. The latter were also concerned because of the decline in the company's share price. The CEO publicly denied any wrongdoing and also privately to the board, and vowed to provide the company with world-class corporate governance. As one step in this effort, the CEO arranged for the board to add several directors who had financial and accounting experience, as well as a director who had worked in a regulatory agency.

In the next several months as the prior directors retired, other independent directors joined the board, including a retired CEO of a major consumer products company and the CEO of an aerospace company. Before deciding to join the board, the new directors each did their own due diligence to assure themselves that there was no foundation in fact about rumors and allegations of inappropriate accounting practices. They were assured by Wall Street lawyers and investment bankers familiar with the company that there was no substance to these allegations.

Thus as the new board began to take shape, there was a strong commitment among the directors to improving the company's corporate governance, and a belief that the CEO/chairman would lead in this effort. A major business publication ran an article at this time about the steps being taken to give the company "world-class corporate governance." In essence, the CEO presented himself as a strong advocate of good governance, and the board members, as well as many in the external world, believed him.

All of this underscores how essential, and yet how hard it is for directors in general, but especially those who would lead a board, to know their CEO deeply. In my experience directors are likely to

give their CEO the benefit of the doubt, especially if the company is performing well. Most CEOs deserve such support, but directors need to be alert to even small signs of behavioral or character flaws.

But in this situation I am describing the directors were being duped! While they believed all was well, officials in the federal government thought otherwise. These officials were gathering evidence which indicated that company officers were involved in accounting fraud to inflate the company's revenue and profit figures and perhaps to enhance their own compensation. In meetings with the company's outside counsel, these government attorneys hinted that they had such evidence, but were not specific about it. The word that came back to the directors was that there was nothing of substance in these allegations. They were not to worry. There was smoke, but the board was told it was a false alarm, both by management and its outside counsel, who as it turned out was also being lied to by the CEO and other senior executives. According to these executives, what the government was hearing were rumors from disgruntled ex-employees.

This was where matters stood until the government announced that they were going to interview certain executives about these allegations. At this juncture, the board members concluded that they needed to understand better the government's position, since it was inconsistent with the constant reassurances they were getting from the CEO and other senior executives. A series of meetings were held between the government attorneys and the board's audit committee. At each session, the government lawyers, without revealing the evidence they had, became more insistent that they were building a case against company executives. They suggested strongly that the board needed to conduct its own investigation of these allegations. In retrospect, it appears that the government was unwilling to share specifics with the board's representatives so as not to jeopardize its cases.

As these events were unfolding the directors were beginning to wonder whether their favorable assessment of their top managers

might be inaccurate. The problem the directors faced in adjusting their perceptions in such circumstances is what psychologists label "cognitive dissonance." In essence, individuals tend to interpret new evidence at least initially as being consistent with their strongly held prior believes, and therefore they are slow to accept new information inconsistent with these beliefs. Before they could decide to act, the board leaders in this company, like others I have observed under similar circumstances, had to grasp the reality that some top managers were dishonest. Yet they still clung to at least the hope their CEO wasn't involved.

Once they had finally accepted the conclusion that there was misconduct among their executives, other issues of board leadership came to the fore. A director who had earlier been elected lead director and was a member of the audit committee asserted himself, along with the audit committee's chair and the third member of the committee. All three argued that the board had no choice but to undertake a thorough investigation of its own. The other board members quickly agreed. Under the leadership of its chair, the audit committee engaged another law firm to undertake the investigation, because the original outside counsel had been compromised by apparent misinformation from management. Forensic accountants were also engaged. The investigation took nine months and cost the company $75 million. The board's investigation resulted in the termination of several senior executives but not the CEO. In essence, it became clear to the board, as it had to the government investigators, that these executives not only had been involved in accounting fraud but had lied to the company's outside council, its auditors, and the board.

Even though these directors still were unclear about their CEO's role in these misdeeds, they did not hesitate to put their time and effort into getting to the facts of the situation. While the actual work of the investigation was conducted by experts, the audit committee chair and his two members devoted many, many hours

to the investigation; clearly this is something anyone who would lead in the boardroom must be willing to do.

As a result of this investigation and government indictments, all the named executives agreed to plead guilty, except for the CEO, who staunchly denied that he knew anything about all this criminal activity. If the government had any evidence implicating him, it was not sharing it with the board, and the audit committee's extensive investigation did not turn up any evidence indicating the CEO had been involved. The board faced a conundrum—their CEO seemed to be doing a good job of keeping the company performing in the marketplace in spite of these serious legal distractions. Furthermore, he denied knowledge of these illegal activities and had been an advocate of good governance at the company. There was no evidence of any wrongdoing by him. To remove him under these circumstances could damage the company and its value to its shareholders, a number of directors argued. Further, the board would be acting without evidence of any wrongdoing by their CEO. Other directors were more cynical. They could not believe that all this illicit activity could have been going on without their CEO's knowledge and consent. After all he was known as a "hands on" manager!

This was the tenor of the discussions that took place informally among the board's leaders, and at two specially called board meetings (without the CEO). At the same time the lead director, the audit committee chair, and other board leaders met with the CEO one on one. Instead of denying any knowledge about the illegal accounting practices, he "clarified" that he knew that theses practices were used, but that he thought this was being legally handled through an accounting reserve. Such a reserve had existed a few years earlier but had been eliminated by the company's former audit firm, a fact the CEO denied understanding.

This caused two of the more proactive directors to insist on another board meeting with the CEO present, so the entire board

could ask him direct questions about whether he was involved and what he knew. As this meeting was being arranged, two other pieces of evidence emerged. First a former board member told one of the current directors that he had observed the CEO in meetings with accounting executives apparently discussing the practices in question. Even more damning, a memorandum was discovered which revealed that the CEO did know about the questionable accounting.

At the specially called board meeting, the directors asked the CEO about these facts and other matters. After he was asked to leave the meeting, the board's deliberations led by the lead director were conclusive. The CEO had to go! The discussion turned to how to ensure continuity in the company's leadership, and one of the independent directors was asked and agreed to serve as interim CEO.

This again illustrates the great difficulty that board leaders and other directors have dealing with dissonant information about their CEO. The board is dependent on its CEO for company success, and when it appears that he has been doing a sound job, directors—even those determined to do the right thing—find it difficult to reach a different conclusion.

In the weeks and months that followed these critical meetings, various board members stepped up to deal with various issues, under the chairman's overall guidance. The audit committee members continued discussions with the government officials and were able to arrange an agreement, under which the company would continue to operate but would pay a fine, and the board and management agreed to resolve the accounting and governance issues. Two other directors volunteered to serve on a search committee to find a new CEO. This process took six months, but a new permanent CEO was put in place. During this time the audit committee also had to ensure that the company was complying with the Sarbanes-Oxley Act.

It would be nice to report that all this went smoothly, but it did not. There was further turnover in senior management,

because of problems in a significant European subsidiary. What the board members and the new management team learned together from all this was that when a company has suffered from such serious legal and ethical lapses there are also likely to be deeper flaws in the company's management practices and systems, and in its culture.

I introduced this example because it illustrates so well the relationship between board leaders' perceptions of their CEO and how they deal with and accept the new facts they are receiving. As long as board members have confidence in their CEO's integrity and his performance, it is difficult to challenge him. This explains one reason why boardroom leaders at other companies embroiled in similar scandals found it so hard to act decisively.

What is also impressive to me about the leadership on this board is how it stuck with the goal of saving its company. Today the company seems well on the road back! Certainly the company's management deserves much credit for this. But so does the board, especially the several directors who stepped up to take various leadership roles as the saga unfolded. Whenever there was a problem or an issue, there were always one or more directors willing to drop other commitments and to devote a large amount of their time to solving the problems in front of them.

Attributes of Effective Board Leadership

The preceding example along with the others I have described illustrate that one attribute of effective leaders is their willingness to commit themselves to take the initiative to solve problems. The directors in the first situation did not hesitate to step in and block the sale of their company. The board member at Medtronic stuck with his convictions, and certainly the leaders of the board I have just described demonstrated similar commitment on many occasions. And I have seen other directors on other boards do the same thing. Effective leaders are willing to devote extraordinary

time and effort to solving problems. But as I have also indicated they have another common attribute—the capacity to spot irregularities, to know when something may be not quite right, and to follow up. The interesting question is why, what motivates these directors to demonstrate these leadership qualities?

I can only speculate based on my experience, but I believe that such leaders have a strong sense that their responsibility is to do the right thing as directors. Their reason for board service is not the money they may receive, nor the status or prestige, but the sense of satisfaction they get in doing the job well. In fact, I have never seen a director who takes on such leadership ask about extra compensation for themselves, even when they have spent many, many hours on an issue. Rather, what usually happens is another board member who has observed and appreciated this effort will suggest that some extra compensation be awarded.

A related quality these leaders share is having or being willing to acquire the knowledge to act effectively. In some instances, the director has a reservoir of knowledge related to the issue at hand. For example, this was true with the Medtronic director. But in many other instances I have seen directors spend a great deal of time and effort to understand facets of the business or the company that are new to them.

In sum, then, two aspects of effective board leaders are their willingness to take on the job and to be inquisitive about the business. But there is another aspect to being an effective leader in the boardroom setting. If you are going to attempt to lead, you want to be as certain as possible that others will follow you. You are undertaking leadership among peers who are used to being leaders themselves and thus may not be enthusiastic followers. So why do other directors accept the leadership of one of their peers? One reason, as I have just described, is because they believe the leader has the required knowledge, or at least will acquire it. This is akin to what sociologists would label influence based on competence. In some instances, this is based on specific knowledge, about a

function or discipline-like accounting or a particular sector like the health care industry. But in many instances, the power granted to a board leader is based on perceptions of broader competence or experience in business. For example, sitting or retired CEOs often emerge as leaders when they join a board, simply because their fellow directors give them credit for having broad competence in business. In fact, it is not an exaggeration to say that when past or present CEOs join a board, the presumption of their peers is that they will emerge as board leaders, because of their experience. In contrast, a new director with a different background, for example in academics or government, has to demonstrate the relevance of his or her knowledge and competence to be accepted as a potential leader. It is for this reason that in a severe and dramatic crisis like that at the American Express board, it is usually a director with experience as a CEO who is accepted as the person to lead the board in solving the crisis.

There is yet another quality effective leaders demonstrate—sensitivity to interpersonal relationships and to group dynamics. An example from another board illustrates this well. This board's longest-serving director, who had become formally recognized as its lead director, was as strong on these qualities as any director I have observed. He was always sensitive to the feelings of managers in the room, as well as to those of other directors. He never dominated a discussion. Rather, he had an exquisite sense of when to speak in a discussion. For example, when the board was at an impasse he would intervene to clarify the issues, and to perhaps suggest a novel solution. If the managers in the room were becoming defensive, as directors asked questions and probed their reasoning, he might step in with a light-hearted comment that would relieve the tension and put the discussion on a more productive track. These attributes and his experience as the CEO of a major company clearly made him the board's leader even before he was formally elected the lead director. His style contributed greatly to the smooth functioning of the board.

Then he reached retirement age and was replaced as lead director by a person who, while he worked diligently at the job, was not as skillful at understanding the group's functioning. To make matters more complicated the director who was elected to replace the retiring director was a CEO of a major *Fortune* 500 company. Because he was a sitting CEO, he was immediately looked up to as one of the board's informal leaders. He relished this position and was not shy about expressing his opinions. After several meetings exhibiting this dominant behavior, which in essence was a violation of the board norms of equality, other directors retreated from the discussion. One even eventually resigned. What had been a very effective group had become dysfunctional largely because of one would-be leader's behavior.

In mentioning such qualities, I do not imply that all those who would be effective leaders have to have the sensitivity and skills of the first director I just mentioned. He seemed almost perfect. I have sat through many boardroom discussions in which directors expressed anger with each other, or were overly tough on the managers in the discussion. Emotion in the boardroom is not a bad thing, as long as there are leaders present who can monitor it and can act to control it. I have seen board meetings in which emotions became so high that two directors were standing on opposite sides of the table arguing with each other in angry voices! But what kept the board working well was a respected leader who said to both, "Come on guys, calm down!" After that meeting, the two angry directors headed to the bar for a drink together.

The fundamental condition for being a successful leader in the boardroom is the simple commitment to do the job. Directors who volunteer to step up to the plate are likely to be given the chance to lead. However, competence, knowledge, and sensitivity to the human relationships and dynamics in varying mixes are also of critical importance. Without them even the most committed director is unlikely to be able to establish himself as a leader

among his fellow board members. Although directors are content to have others share leadership responsibility, they expect them to succeed, and these are the qualities which my experience indicates lead to success.

As I stated earlier, effective boards seem to have multiple leaders. In fact, one can argue the more the merrier. Remember, directors are part-timers whose time is always constrained, and they welcome others who will share the workload, including that of leading. Obviously the several leaders on each board have to work together, and there have to be complementary roles and coordination among the leaders. In my experience ensuring this outcome is the job of the chair.

Having boards with strong cadres of leaders, as I have also suggested, is the best assurance we can have that boards can and will live up to the increasing demands being placed upon them. This is not to downplay the importance of clear definitions of each board's role, nor the design of the board to accomplish this purpose. It is just that the practices and procedures in each board's architecture will only be effective if there is leadership to make them so.

So how do boards ensure themselves of a cadre of effective leaders? The answer to me is obvious! Directors must be selected who have the qualities I have just discussed in mind. In most boardrooms today, even those with active and responsible corporate governance committees managing the selection and nominating process, three criteria seem sufficient. First, does the director have the skills and experience the board needs to add, such as finance, or marketing, or technology? Second, is the director a person of integrity? Third, is the candidate someone who seems likeable and who is willing to engage constructively with other board members and will fit into the group that is the board? Although there is nothing particularly flawed about these criteria, I would argue that boards that want to assure themselves

of an adequate pool of leaders need to examine potential directors more deeply:

1. Why does the candidate want to serve on the board? The answer I would seek is because he wants to see the company succeed from his efforts, and because he feels he will learn from and get satisfaction from the experience.
2. In addition to a particular competence or set of skills, does the candidate have an inquisitive nature? Does she seem interested in understanding how the company functions and why?
3. Given the person's main career (for example, CEO, CFO, academic, government), how will others perceive him, and what will be his likely reaction? Can he handle being looked up to because he has been or is a CEO, for example? Or can he handle the fact that a lack of business leadership experience may make it difficult to take leadership on issues?
4. Finally, how well does the candidate understand others and the dynamics of groups?

Getting answers to such questions will require not only interviewing the candidate but also getting input from others who have watched him in action. It will require more effort than is currently devoted to selecting directors by most boards. However, if boards want a plentiful supply of leaders around the table, and I believe they should, the effort will be well worth it.