PART ONE

Board Leadership and Dynamics

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CHAPTER ONE

A Blueprint for Building Better Boards

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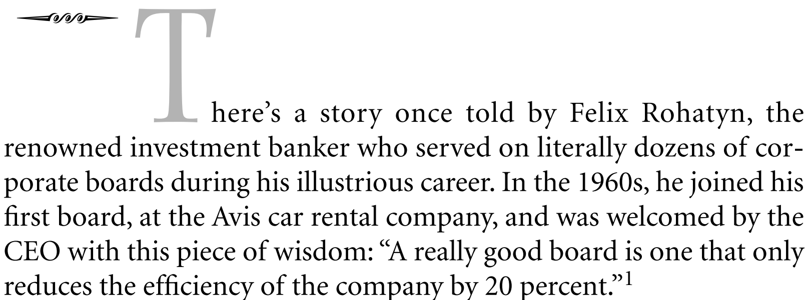

There's a story once told by Felix Rohatyn, the renowned investment banker who served on literally dozens of corporate boards during his illustrious career. In the 1960s, he joined his first board, at the Avis car rental company, and was welcomed by the CEO with this piece of wisdom: "A really good board is one that only reduces the efficiency of the company by 20 percent."[1]

That pretty well sums up the low esteem in which boards have been held over the years. It certainly captures the disdain harbored by many CEOs who viewed their boards as inconsequential at best, and at worst, as meddlesome obstacles to the efficient exercise of executive power. The possibility that boards might actually contribute some element of value just didn't factor into the equation.

It's time for some new math.

Today, boards have reached a historic fork in the road. In the wake of an unprecedented series of corporate scandals in both the United States and Western Europe, maintaining the status quo simply isn't an option. We've known for years that traditional boards were generally passive, compliant, and unproductive assemblages of individuals who would gather periodically to rubber-stamp the CEO's edicts. It turns

out that was the best scenario. The corporate scandals of recent years aimed the spotlight on one board after another where the pervasive cronyism, cowardice, and collusion produced a toxic combination of sloth and sleaze. Those revelations, and the public demand for corporate reform, are forcing boards to look in the mirror and ask themselves profound questions about what role they should play in governing their organizations and how to constructively manage the shifting balance of power between the board and the CEO.

Every board faces a choice. On one hand, they can take the path of least resistance—minimal compliance with the new technical requirements imposed by legislators and stock exchanges. To be sure, compliance is important, but in our view it represents nothing more than the lowest common denominator of sound governance, a corporate version of the Hippocratic oath: "Above all, do no harm."

Our firm belief—and the premise of this book—is that directors and CEOs should choose the more difficult but ultimately more rewarding path of building better boards that actually contribute substantial value to the organizations they serve and the shareholders they represent.

It's easy to understand the overwhelmingly legalistic thrust of the so-called reforms enacted in recent years. Yet, although they might provide comfort to those whose main concern is ensuring that boards do no harm, they do little to help boards create value. Transparency in financial reporting, appropriate expertise on the board audit committee, and an explicit code of ethics represent little more than the "table stakes" of adequate governance; they're aimed at forcing boards to meet the basic legal requirements they should have been living up to all along. There's no added value in any of that.

Now, as CEOs experience a diminution of their "imperial" powers and boards contemplate the best way to fill the leadership vacuum, there's a unique opportunity for directors to commit themselves to a higher standard of performance. We are absolutely convinced that active and appropriately engaged boards, drawing on their members' collective experience, insights, and intellect, can partner with senior management in an environment of constructive contention to produce better decisions than management would have made on its own.

Here's the rub: boards can do that only if they learn to operate as high-performance teams, a role that represents a fundamental, even radical, departure from their deeply entrenched customs and practices. As

we'll explain throughout this book, building a better board is a transformational exercise, one specifically designed to overcome the inherent and powerful obstacles to the board's capacity to function well as a team. Our goal here is to provide a blueprint for doing just that: for creating boards composed of the right people using the right processes to do the right work in an environment shaped by the right culture.

Here's an example of what we mean by boards adding value.

Henry Schacht, the retired chairman and CEO of Lucent Technologies, recalls that when Lucent was spun off by AT&T in 1995, the new company set up shop in the Bell Labs headquarters, a serviceable but somewhat outdated building that had seen better days. Schacht, something of an architecture buff, asked world-renowned architect Kevin Roche to begin working on plans for a brand-new headquarters building. After months of planning, Schacht proudly took his proposal to the Lucent board, which essentially asked him if he was out of his mind in light of all the other issues Lucent was dealing with at the time. "You know what? They were right," Schacht told us later. "We had a tough discussion, and we ended up making a different decision than I would have made on my own, and that's a good thing. That's an operational definition of value-added."

It's more than an academic question to ask how much value Enron's board would have contributed if it had questioned the bewildering off-the-books partnerships management was creating, or if WorldCom's board had halted top management's questionable accounting practices or loans to themselves, or if Disney's board had exercised some control over Michael Eisner's hiring and firing of top executives, or if Time-Warner's board had stood up to Gerald Levin and blocked the merger with AOL, a move that ultimately erased more than $200 billion in shareholder value.

In each of those cases, the board not only failed to add value, it even failed to preserve value. The good news is that in recent years we've seen more and more opportunities where boards have been adding value—at TRW, for instance, where the board stepped in and held the company together following the new CEO's sudden departure to Honeywell; at Lucent, where the board prevented Schacht's successor from making a series of potentially disastrous acquisitions; at Best Western International, where a badly fragmented board came together to block the CEO's proposed spin-off of the company's non-U.S. operations and then took an active role in working with management to

rethink the strategy, design robust new performance metrics, and reshape the corporate culture.

THE DUELING PHILOSOPHIES OF GOVERNANCE

Just to be clear: the idea that boards can be a source of value isn't new. There's long been a school of thought that the board—or more specifically, its individual members—might constitute a *resource.* Through their personal networks, directors could help the company establish contact with new customers or partners, tap into new sources of capital, or gain a foothold in new markets or technologies. Ideally, some directors might actually provide the CEO with sound advice and wise counsel from time to time.

But the resource perspective has traditionally taken a distant backseat to the prevailing view that the board's central purpose is *control*—to act as a watchdog to make sure that the shareholders aren't robbed blind by "the agency," the hired managers who run the company. The control perspective has provided the philosophical underpinnings for the governance reform movement in the United States. That movement surfaced quietly in the late 1980s, then took on new urgency with the boardroom revolts of the early 1990s, which saw the ouster of CEOs at iconic U.S. institutions such as General Motors, American Express, and Kodak. Shareholder activism gained momentum throughout the 1990s, fueled by the manic merger and acquisition activity that resulted in so many ill-considered, poorly executed deals that erased billions of dollars of shareholder wealth.

And then came the opening years of the new century. The tech bubble burst, the post–9/11 economy went into a tailspin, and the unraveling of artificially inflated corporate results revealed an alarming pattern of questionable business schemes, fraudulent accounting practices, and appalling management excesses. At first, the unprecedented scandals seemed to be a U.S. phenomenon, involving a now-familiar list of corporate culprits—Enron, Tyco, WorldCom, Adelphia, Rite-Aid, HealthSouth, and Hollinger, to name a few. But Europe saw its own share of scandals at leading companies such as ABB, Skandia, Ahold, and Parmalat, while Canada added Nortel to the list.

Society's ire was targeted both at the CEOs who had abused their positions, either for financial gain or personal aggrandizement, and at the boards that had failed to stop them from running amok. It

seemed that one board after another had either been bedazzled by a larger-than-life CEO, befuddled by business schemes they barely understood, or simply were asleep at the switch.

The response was swift and harsh, and it clearly reflected the control theory advocated for years by self-described governance watchdogs. The Sarbanes-Oxley legislation and the new listing requirements adopted by the New York Stock Exchange and Nasdaq had one clear purpose: to impose new structures and formal procedures that would minimize opportunities for financial mismanagement and conflicts of interest. Nearly all the reforms were about maintaining tighter control through tougher oversight.

At one level, it's hard to argue that reforms weren't needed. No one disputes that the governance process was badly broken at some companies. Yet so much of the public discourse and institutional response to the governance crisis has been shaped by the control theory and fixated on legal compliance as the source of good governance. For us, that creates some real concerns.

First, we reject the underlying notion that you can legislate board effectiveness. You can't mandate independent judgment, intellectual curiosity, constructive dissent, broad participation, or any of the other hallmarks of truly great boards. To quote Bill George, the highly respected retired CEO/chairman of Medtronic, Inc., "A lot of people who have not served on the inside think the reforms can be imposed from the outside. These are necessary, but not sufficient conditions for good governance."[2]

Second, the governance reform dogma rests on some shaky articles of faith; for example, the conventional wisdom is that boards dominated by a majority of independent directors are superior to those that aren't. In fact, a widely cited meta-analysis of fifty-four different studies "showed no statistical relationship" between board independence and company performance.[3] The same holds true of splitting the chairman and CEO roles, an arrangement that prevails in the United Kingdom and Canada but is still resisted by more than 70 percent of U.S. boards. There are good arguments for both models, but no clear evidence that bifurcating the roles results in better performance. In fact, a recent study by Booz Allen Hamilton found that companies in both North America and Europe in which the roles were split actually averaged lower returns for investors.[4]

Third, the obsession among some governance watchdogs and journalists with the technical aspects of corporate reform perpetuates a "governance by the numbers" mind-set that directs attention away from the most meaningful elements of sound governance. Take *Business*

Week's annual ranking of the "Best and Worst Boards," which is partly based on a point system that rewards compliance with various good governance criteria. Using those standards, both Sunbeam (1997) and Lucent (2000) made the list of best boards just as their CEOs were driving them to the brink of disaster. Yet Apple Computer was named one of the worst boards in 2002 because CEO Steven Jobs flunked *Business Week*'s requirement for purchasing his own company's stock—although Jobs somehow went on to mastermind one of the most stunning turnarounds in recent corporate history.

Perhaps the most extreme example of governance by the numbers is the continuing campaign to have Warren Buffet, perhaps America's most astute investor, removed from the Coca-Cola board's audit committee. The argument goes that Buffet, the chairman of Berkshire Hathaway, can't properly represent Coke's shareholders because two of Berkshire's units have purchased $185 million in Coke products. The implication that Buffet is somehow a management stooge who can't look out for the shareholders' best interests ignores the fact that Buffet's company is itself Coke's biggest shareholder (owning stock valued at more than $8 billion) or that Buffet personally played a key role in the board's ouster of CEO Douglas Ivester. The campaign defies logic and common sense, but it illustrates the dangers of the watchdog mind-set at its most rigid and unreasonable.

Our fourth concern is that the new regulations may be forcing boards to spend disproportionate time on activities that aren't likely to create value. Our own research, for example, found that more than 40 percent of directors feel they're now spending more time on compliance and less time on corporate strategy.[5] We're also finding the Sarbanes-Oxley reporting requirements shower directors with more financial data than they can possibly put to good use, exacerbating the growing concern that directors are choking on meaningless data but starved for useful information.[6]

Our final concern is that a narrow focus on compliance can actually prove dangerous if it creates a false sense of security. There's a risk that far too many companies will spend way too much time and money convincing themselves and their shareholders that they have created good governance when, in point of fact, they've done little to reduce the risk of meltdowns or improve their leadership and governance. It's all too easy to have good governance on paper and bad governance in practice; let's not forget that the Enron and HealthSouth boards were widely hailed as models of quality and independence.

It would be a wasted opportunity of historic proportions if all the attention now being focused on boards resulted in nothing more than a few technical fixes and a thicket of audit reports. We should demand more than that, searching for ways to build better boards that add real value to the organizations they serve.

THE BOARD AS A HIGH-PERFORMANCE TEAM

As we mentioned earlier, there has always been a school of thought that individual directors could act as resources, providing value on an ad hoc basis. What's new is the idea that the board, effectively constituted as a high-performance team, can provide ongoing collective value that's far greater than the sum of its individual parts. It's based on the belief that a board's collective experience, skills, and insights, when properly engaged, can enable management to make better decisions and run the company more effectively than it would have if left to its own devices. We've been suggesting that idea since the mid-1990s, and it's been gratifying to see others espouse the same notion over the years.[7, 8]

But it's easier said than done. As we'll discuss more fully in later chapters, the board operates under unique circumstances that inhibit its ability to function like other teams. It has unique legal requirements, meets infrequently and for only short periods of time, consists of a group of powerful people who are accustomed to leading their own teams, and involves fluid roles and ambiguous power relationships—for example, when the same person is both CEO and chairman, the person who leads the board as chairman simultaneously reports to the board as CEO.

So it's not enough to say the board should function as a team. The real question—and the question we hope to answer in this book—is this: Exactly how does a board go about transforming itself from a ritualistic appendage to a real team? Not only that, but in today's perilous corporate environment, how does it strike the proper balance between a do-nothing rubber stamp and an out-of-control lynch mob ready to assume management's rightful duties or prematurely toss the CEO overboard at the first sign of trouble? More specifically, a value-adding board has to address these three challenges:

- How do you create a board that is truly effective—one that not only meets its minimum legal obligations but also becomes a source of added value to its company?

- How do you design the work of the board so that it achieves an appropriate level of engagement without overstepping its proper role, which is to ensure that the company is managed effectively rather than to manage the company?
- How do you build an effective relationship between the board and the CEO, one that empowers the board without hampering the CEO's ability to lead?

Our research and experience indicate that a few boards have already figured out the answers, but not many. Most boards have a general sense that something's not working, but no clear idea of where they want to be, or how to get there. We hope that's what this book will provide: a blueprint for building better boards.

THE BLUEPRINT: BUILDING BETTER BOARDS

Every board is unique; each faces a particular set of challenges, and there's no quick fix that will solve every problem for every board. Nevertheless, based on our work over the years with more than fifty boards in the United States, Canada, and Western Europe, we have developed a board-building framework that suggests both a conceptual framework and some specific processes that apply in a multitude of situations. In this section, we'll describe the framework and explain how the remainder of the book is organized to provide a deep look at each step (see Figure 1.1).

Initial Steps: Taking Stock and Setting Direction

Later in this chapter, we'll dive into the first two steps in the process. The first step is what we refer to as *taking stock.* This is essentially a diagnostic phase, the necessary precursor to all the work that follows. The goal here is twofold: to identify the precise problems that are preventing the board from being as effective as it should, and then, even more importantly, to use a carefully facilitated process to build consensus about what the problems are and a board commitment to doing something about them. To be effective, board-building can't be forced; if the majority of directors don't think the work is important and worth the time and effort, the process will collapse in the starting block.

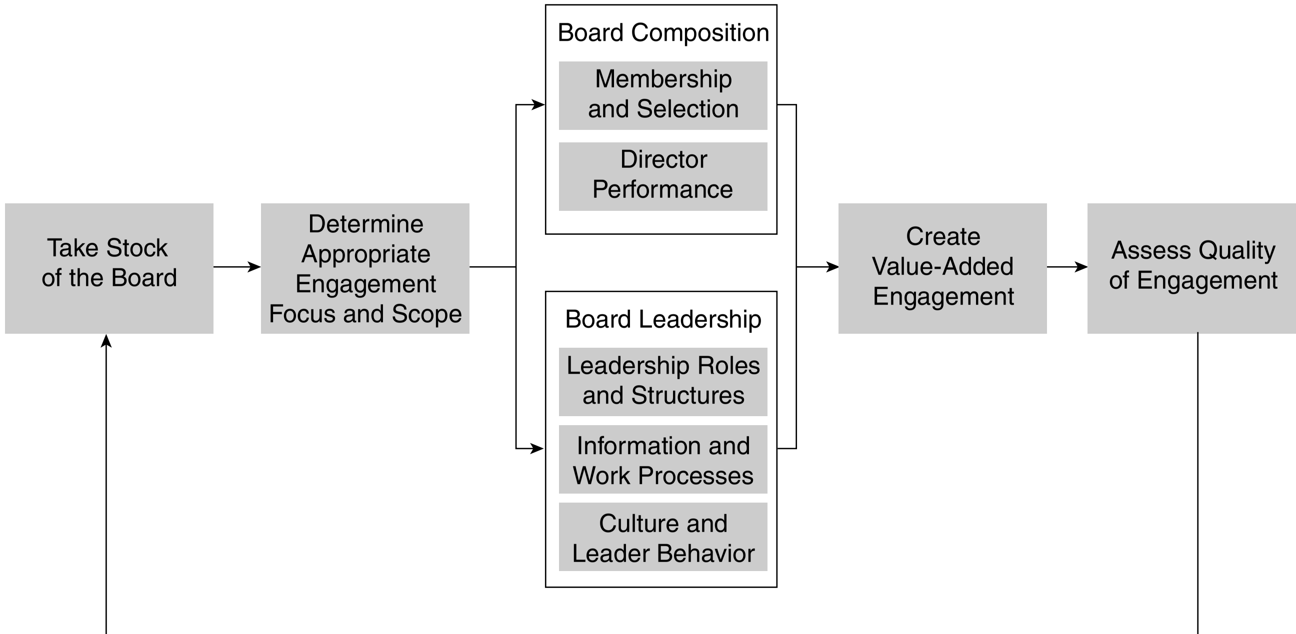

Figure 1.1. Board-Building Framework.

In the second step, the discussion turns into real work when the board and management survey the entire landscape of governance responsibilities and reach agreement on which work is primarily the board's, which is primarily management's, and which should be shared. This step is absolutely critical to shaping the board as a team. The outcome provides both a road map for moving forward with real work—and an appropriate level of engagement—and the foundation for the final step in the process, which is to assess the board's effectiveness and to evaluate how closely its activity matches its aspirations.

Board Composition

Fundamental to the success of any team is having the right people around the table, and the board is no exception. As we'll discuss in Chapter Two, recruitment of new board members is one of the areas where the shift in power from the CEO to the board has been most dramatic. It's crucial for board leaders to create explicit profiles that will guide their recruitment and enable them to use each appointment to help shape a board that has the collective experience, skills, and personal attributes to do real work collaboratively and effectively. That will require robust recruitment strategies that search beyond the personal networks of the CEO and the board—the "usual suspects"—to find qualified candidates.

Selection is only the first step in making sure the board has the right people. In Chapter Three, we'll explore the aspect of composition that boards have been much more reluctant to address: the performance of individual directors. As directors often tell us, it's generally easier for most boards to remove an underperforming CEO than an underperforming director. In both the United States and the United Kingdom only about a quarter of all boards have established rigorous processes for regularly evaluating each director's performance and using the feedback to either improve performance or initiate removal. We'll describe some effective tools we've developed with boards to do just that.

Board Leadership

The next set of chapters focuses specifically on the role of board leaders in building high-performance teams.

Chapter Four sets the scene by exploring the emerging leadership roles and structures of boards. In the United States, the CEO's control over the board was unchallenged and absolute at most companies until very recently. In the wake of the corporate scandals, and the

structural changes that followed, CEOs no longer control the powerful compensation, nominating, and audit committees. Independent directors are filling a variety of leadership roles, as lead directors, presiding directors, and nonexecutive chairmen. Boards are required to meet periodically in executive session without the CEO present. We're now in a period of experimentation, and each board has to decide what division of responsibilities works best for it.

In Chapter Five, we take a close look at what leaders can do to improve the quality and productivity of their ongoing work processes. Specifically, we'll explore ways in which leaders can improve the absolutely essential flow of information to the board, how they can shape agendas to make the best possible use of the board's limited opportunity for working together face-to-face, and how they can maximize the value of the independent directors' executive sessions, perhaps the single most valuable change to come out of the recent governance reforms.

The first five chapters deal with how to get the right people doing the right work, using the right processes. Any board—or any team for that matter—can get those first three approximately right, but without the right culture, which is the topic of Chapter Six, the other three won't matter. This is perhaps the biggest challenge for board leaders: to reshape a deeply entrenched, traditional culture of passivity, deference to management, and excessive formality into a culture that encourages independence, constructive dissent, broad participation, unfettered openness, and spirited inquiry. The burden falls squarely on the shoulder of board leaders; no one else can change the culture or keep it from either slipping back to the old ways or hurtling out of control into dysfunctional acrimony.

Value-Added Engagement

If the board has successfully mastered the requirements up to this point, then ideally the outcome will be engagement that adds value to the organization. Beyond the area of audit and financial reporting, which has been the primary focus of the recent governance reforms, we think there are four critical areas where the board is uniquely positioned to add significant value to the overall quality of an organization's governance.

- *Corporate strategy* (Chapter Seven): Many directors believe that the development and oversight of corporate strategy is one of the board's most critical functions (the other being hiring and firing of CEOs), but it's also an area where they believe they've been

least effective. A high-performing board, through its collective experience, expertise, and rigorous questioning, can add immense value to management's thinking. Ineffective boards either rubber-stamp management's plans or get too involved in the details. We will describe a process that, based on our experience, allows for appropriate engagement and added value.

- *CEO performance evaluation* (Chapter Eight): Traditionally, the board mainly relied on lagging indicators of financial performance to determine the CEO's compensation. But an effective evaluation process should do much more. Although it should recognize the importance of the financials, it should also evaluate the CEO's leadership based on outcomes that are directly within his or her control, and use the evaluation process to shape organizational goals for the coming year.
- *Executive succession* (Chapter Nine): Increasingly, boards are demanding an active role in deciding who will be the next CEO. It's not sufficient for the CEO to come up with a single candidate and ask the board to ratify that choice. Boards need to get involved early to ensure identification of a range of candidates who will be evaluated, provided with opportunities to broaden their skills and experience, and exposed to the board in various settings. Boards are also realizing that their role doesn't end when the new CEO is selected; they have a unique responsibility to help the new chief executive get off to a good start.
- *Risk assessment and crisis management* (Chapter Ten): The board is uniquely positioned not only to oversee a rigorous process for assessing risk and planning for crises but also to take center stage when the CEO is the focal point of a crisis, a situation that's not uncommon these days. The board can also contribute substantial value by insisting on a thorough analysis of the underlying institutional problems that might have led to the crisis in the fist place.

Assessment of Engagement

The final step in the board-building process is for the board to regularly assess the quality of its engagement (Chapter Eleven). Annual assessment was among the new requirements imposed on U.S. boards in 2002. But it's a stark example of the difference between minimum compliance and a robust process. A board can easily fulfill the NYSE

listing requirements by checking off the boxes on a pro forma report cobbled together by some other company's lawyers, verifying whether it is in compliance with all the other technical requirements. But that won't tell you a thing about whether the board is doing the right work and doing it well. As we suggested earlier, the assessment should flow from the board's decisions about what work it thinks is important and how deeply it should be engaged, and measure the gaps between its intentions and accomplishments.

Board Issues in Canada and the United Kingdom

Corporate governance has developed in different ways in the United States, Canada, and the United Kingdom. Each country has its own set of laws, listing regulations, and governance guidelines reflecting its history, traditions, and culture. Overall, we're struck more by the similarities than the differences (the differing attitudes toward splitting the CEO and chairman roles notwithstanding). Based on our work with boards in all three countries, we are convinced that the framework and underlying concepts of the board-building framework apply in all three. However, acknowledging the heavy emphasis on the United States throughout much of this book, the final chapters focus on current governance issues of particular significance in Canada (Chapter Twelve) and the United Kingdom (Chapter Thirteen).

BOARD-BUILDING: TAKING STOCK

With that framework in mind, let's begin the board-building process with the first step: taking stock of the board.

The process of board-building rarely starts with a blank page (although there is the special case of a new company or spin-off that is creating a brand-new board). Each board enters the process at a different place, based on its own history, assumptions, culture, composition, and leadership. The first step is to understand the feelings, perceptions, and evaluations of both directors and senior managers about how the board operates today. More often than not, the challenge is how to take an existing board and reshape it into a productive team. Without some initial diagnostic work, it's practically impossible to know where to start.

For example, in recent years we worked with a number of Fortune 100 companies, in vastly different industries, where the initial diagnosis

in each case pointed unequivocally to composition as the board's biggest problem. In one case, the problem was behavior; certain board members were so disruptive, disloyal, and dysfunctional that the board couldn't get any work done or be confident that any of its deliberations would remain private. In others, the boards just didn't have enough directors who knew enough about the company and its industry to make any worthwhile contribution. In those situations, it was pointless to work on any other changes until there'd been a major change in the cast of characters.

Yet we've also been brought into situations where the board's makeup was just fine; the members just weren't spending their time on the right work, or if they were, they didn't know how to move the ball forward. Those situations suggested a course of action unrelated to composition.

To be effective this initial phase requires a more open-ended diagnostic process than what you'd normally find in a formal assessment. Asking people to check off boxes on a structured survey won't get the job done. This requires in-depth, confidential interviews with everyone involved.

Gathering the information is only the first step. The real goal is to use the feedback as the basis for discussions that will create consensus about the board's challenges and generate collective energy to do something about them. There has to be general agreement that the pursuit of greater effectiveness is a sufficiently worthwhile goal to merit the time and effort the work is likely to take. Every board is squeezed for time; a rigorous and often-uncomfortable process of self-examination and change isn't likely to win much time on the agenda unless the board first decides that this work really is a priority.

(This is one of those situations—and, just to give fair warning, there will be a few others sprinkled through this book—where it makes sense to enlist the help of outsiders. There are a number of ways to find out how directors and executives are feeling about the board, but confidential interviews with impartial outsiders who have experience in gathering, analyzing, and constructively presenting the feedback often work best.)

THE KEY ISSUE: APPROPRIATE ENGAGEMENT

The new relationship between boards and management is what most often triggers a board's reexamination of its work. The rules of the

game have changed, and the key players in corporate governance are trying to figure out how to play their new positions.

In general terms, there's widespread confusion about what work is properly the board's, what work should be management's, and what work ought to be shared. More specifically, our work with one board after another has started with the CEO or chairman telling us something like this: "I have some directors who are very traditional, very passive, and they just sit and wait for the CEO to tell them what to do. And I have others who think their job is to manage the company, and they want to run the place. We can't get anything done."

From every corner, boards are told the answer is simple: they need to overcome their traditional passivity, and become active and empowered. In a perfect world, the board would:

- Bring deep wisdom and broad perspective to the table, providing the CEO with useful advice and acting as a sounding board and source of support.
- Help influence critical outside constituencies.
- Create a solid front to the outside world during crises.
- Assist in effectively managing succession.
- By doing all of the above, safeguard shareholder interests.

But it's not that simple; activism and empowerment can be double-edged swords. Taken to extremes, they can lead to:

- Meddling and micromanagement that distract executives, consume inordinate chunks of their time, and interfere with the orderly operation of the company
- Power struggles at the top of the company
- Damage to the CEO's credibility outside the company
- Inappropriate limits on the CEO's compensation
- Interference with orderly executive succession
- Hasty dismissal of the CEO as an expedient solution to more complex problems

Our point is that it's not enough simply to decide that a board should be active, independent, and empowered. The real question is

what does engagement look like for a particular board in a given situation, and what are the options? One way to engage directors in a preliminary discussion is to have them describe their own view of where their board sits on the continuum, ranging from the least to the most engaged boards. Broadly speaking, there are five general archetypes of boards (see Figure 1.2):

- *Passive:* The traditional model. The board's activity and participation are limited, and at the CEO's discretion. The board has limited accountability, and its main job is ratifying management decisions.

Figure 1.2. Degree of Board Engagement.

- *Certifying:* Places a heavy emphasis on the importance of outside directors, and certifies to shareholders that the business is being managed properly and that the CEO is doing what the board requires. Directors stay informed, oversee an orderly succession process, and are willing to change management if necessary. They are credible to shareholders.
- *Engaged:* Partners with the CEO, providing insight, advice, and support on key decisions and implementation. This kind of board recognizes its ultimate responsibility for overseeing CEO and company performance; meetings typically involve substantive discussion of key issues and decisions. Board members need some level of industry and financial expertise to provide value. They actively work at defining their roles and required behavior, as well as the boundaries of CEO/board responsibility.
- *Intervening:* Most common mode during crises. The board holds frequent and intense meetings, and becomes deeply involved in key decisions.
- *Operating:* The deepest level of ongoing involvement. The board makes key decisions, and management implements them. This model is frequently found in the early stages of start-ups, when top executives often bring some special expertise but lack broad management experience, which the board helps to provide.

Of course, these archetypes are just that—examples of each type of engagement in its purest form. In the real world, boards slide back and forth across the scale, exhibiting different degrees of engagement with regard to different issues. A passive or certifying board, for instance, can suddenly find itself facing a crisis in which it has to act as an intervening board to remove the CEO, and it may then play the role of operating board until a new CEO is in place.

The purpose of the engagement archetypes isn't to squeeze a particular board into a particular box. Rather, the framework provides a useful starting point for a discussion within the board as it begins to grapple with questions such as, "Where are we on this scale?" and "Where and how can we best add value?" Ideally, that discussion leads to the next step in the board-building process: moving beyond generalities and specifically identifying exactly what work the board should be doing, and with what intensity and engagement.

MAPPING THE BOARD'S FOCUS AND ENGAGEMENT

The initial stage of the process is fairly straightforward. It involves creating a framework that lists all of the areas in which the board, at some time or another, might possibly be involved, and then asking each director to rate each area on the degree to which the board is actually involved, and the level at which he or she thinks the board *should* be involved (see Exhibit 1.1).

The trick here is to think in specific terms that go beyond the fairly general legal obligations of the board. These include approving major corporate actions such as making acquisitions; providing counsel to senior management; hiring, firing, setting compensation, and evaluating the performance of the CEO; ensuring effective audit procedures; and monitoring the company's investments for legal compliance.[9] The new requirements call on boards to spell out those duties in written charters, and at the end of each year, to go down the checklist and affirm, "Yes, we did that." But that's a recipe for compliance, not necessarily for good governance.

It's much more useful for boards to translate those legal mandates into specific areas of work, which might be grouped this way:

- Strategy, including strategic direction, plans, and implementation
- Strategic transactions, such as major investments, mergers, acquisitions, and spin-offs
- Operations, including research and development, manufacturing, marketing and sales, and information technology
- Human resources and organization, involving issues such as leadership development, executive compensation, human capital, organizational structure, and corporate culture
- Financial management, including financial strategy, capital structure, liquidity management, dividend policy, and financial reporting
- Risk management, including enterprise risk management, ethical performance and compliance, and audit
- External relations, which might involve the positioning and integrity of the brand, shareholder relations, legal and regulatory affairs, and relations with other major constituencies such as customers, communities, regulators, and government officials
- CEO effectiveness, including critical responsibilities such as performance appraisal, compensation, and succession

Exhibit 1.1. Areas of Potential Board Engagement.

	Current State						Desired State					
Please circle the response that best corresponds to the level of board engagement.	No engagement	Low engagement	Moderate engagement	High engagement	Exclusive engagement	Not applicable/ Don't know	No engagement	Low engagement	Moderate engagement	High engagement	Exclusive engagement	Not applicable/ Don't know
Strategy												
1. Strategic direction	1	2	3	4	5	?	1	2	3	4	5	?
2. Strategic plans	1	2	3	4	5	?	1	2	3	4	5	?
3. Strategy implementation	1	2	3	4	5	?	1	2	3	4	5	?
Strategic transactions												
4. Major investments	1	2	3	4	5	?	1	2	3	4	5	?
5. Portfolio change	1	2	3	4	5	?	1	2	3	4	5	?
Operations												
6. Research and development	1	2	3	4	5	?	1	2	3	4	5	?
7. Manufacturing	1	2	3	4	5	?	1	2	3	4	5	?
8. Marketing and sales	1	2	3	4	5	?	1	2	3	4	5	?
9. Information technology	1	2	3	4	5	?	1	2	3	4	5	?
Human resources and organization												
10. Leadership development	1	2	3	4	5	?	1	2	3	4	5	?
11. Non-CEO executive compensation	1	2	3	4	5	?	1	2	3	4	5	?
12. Human capital	1	2	3	4	5	?	1	2	3	4	5	?
13. Organization	1	2	3	4	5	?	1	2	3	4	5	?
14. Corporate culture	1	2	3	4	5	?	1	2	3	4	5	?

(continued)

Exhibit 1.1. continued

Please circle the response that best corresponds to the level of board engagement.	Current State						Desired State					
	No engagement	Low engagement	Moderate engagement	High engagement	Exclusive engagement	Not applicable/ Don't know	No engagement	Low engagement	Moderate engagement	High engagement	Exclusive engagement	Not applicable/ Don't know
Financial management												
15. Financial strategy	1	2	3	4	5	?	1	2	3	4	5	?
16. Capital structure	1	2	3	4	5	?	1	2	3	4	5	?
17. Liquidity management	1	2	3	4	5	?	1	2	3	4	5	?
18. Dividend policy	1	2	3	4	5	?	1	2	3	4	5	?
19. Financial reporting	1	2	3	4	5	?	1	2	3	4	5	?
Risk management												
20. Enterprise risk management	1	2	3	4	5	?	1	2	3	4	5	?
21. Ethical performance and compliance	1	2	3	4	5	?	1	2	3	4	5	?
22. Audit	1	2	3	4	5	?	1	2	3	4	5	?
External relations												
23. Brand positioning, integrity	1	2	3	4	5	?	1	2	3	4	5	?
24. Shareholder relations	1	2	3	4	5	?	1	2	3	4	5	?
25. Legal and regulatory	1	2	3	4	5	?	1	2	3	4	5	?
26. Other constituencies	1	2	3	4	5	?	1	2	3	4	5	?

CEO effectiveness												
27. CEO performance appraisal	1	2	3	4	5	?	1	2	3	4	5	?
28. CEO compensation	1	2	3	4	5	?	1	2	3	4	5	?
29. CEO succession	1	2	3	4	5	?	1	2	3	4	5	?
Corporate governance												
30. Board effectiveness	1	2	3	4	5	?	1	2	3	4	5	?
31. Director selection	1	2	3	4	5	?	1	2	3	4	5	?
32. Director assessment	1	2	3	4	5	?	1	2	3	4	5	?
Other (please specify)												
33. ______________________	1	2	3	4	5	?	1	2	3	4	5	?
34. ______________________	1	2	3	4	5	?	1	2	3	4	5	?

- Corporate governance, which covers activities relating to the board's own leadership, performance, and composition

For each specific area of responsibility in each general group, directors rate the board's actual and optimal level of engagement on a sliding scale that describes the relative intensity of engagement by the board and senior management, respectively, ranging from no engagement to exclusive engagement. At one end of the scale are activities that are the primary responsibility of management and in which the board has no involvement; at the other end are areas that fall exclusively within the purview of the board, which merely keeps management informed of its decisions. Boards that have had the greatest success with this form of assessment have asked senior managers to fill out the same rating form.

For example, using a similar approach, the board of a Fortune 500 company where the CEO's predecessor had recently been ousted developed the following comparison (see Figure 1.3) of its current and desired levels of engagement. Interestingly, there was only one area—operations—in which the board did not seek significantly more engagement than it already had, a view that mirrors a concern common among many boards that feel too bogged down in operational details. In contrast, the board expressed a clear desire for much more active engagement in such critical areas as CEO effectiveness, corporate governance, strategy, strategic transactions, and risk management.

This information can be used in several important ways. The first is a gap analysis reflecting whether directors feel the board is appropriately involved in the right work. Reconciling the "shoulds" and "actuals" is an essential step in matching the board's real work with its general view of its role. The second gap analysis illustrates how directors' views differ from those of managers regarding the board's appropriate role, an issue that's often lurking in the background but that no one feels comfortable in raising. It's worth noting that the data sometimes provide some pleasant surprises; at one large media company, directors were surprised to find that in some areas management rated the board's involvement more highly than the board had rated itself.

SUMMARY

Looking back at the first two steps of the process we've just described, and thinking ahead to the steps that follow, we'd like to highlight two themes that will recur throughout our discussion.

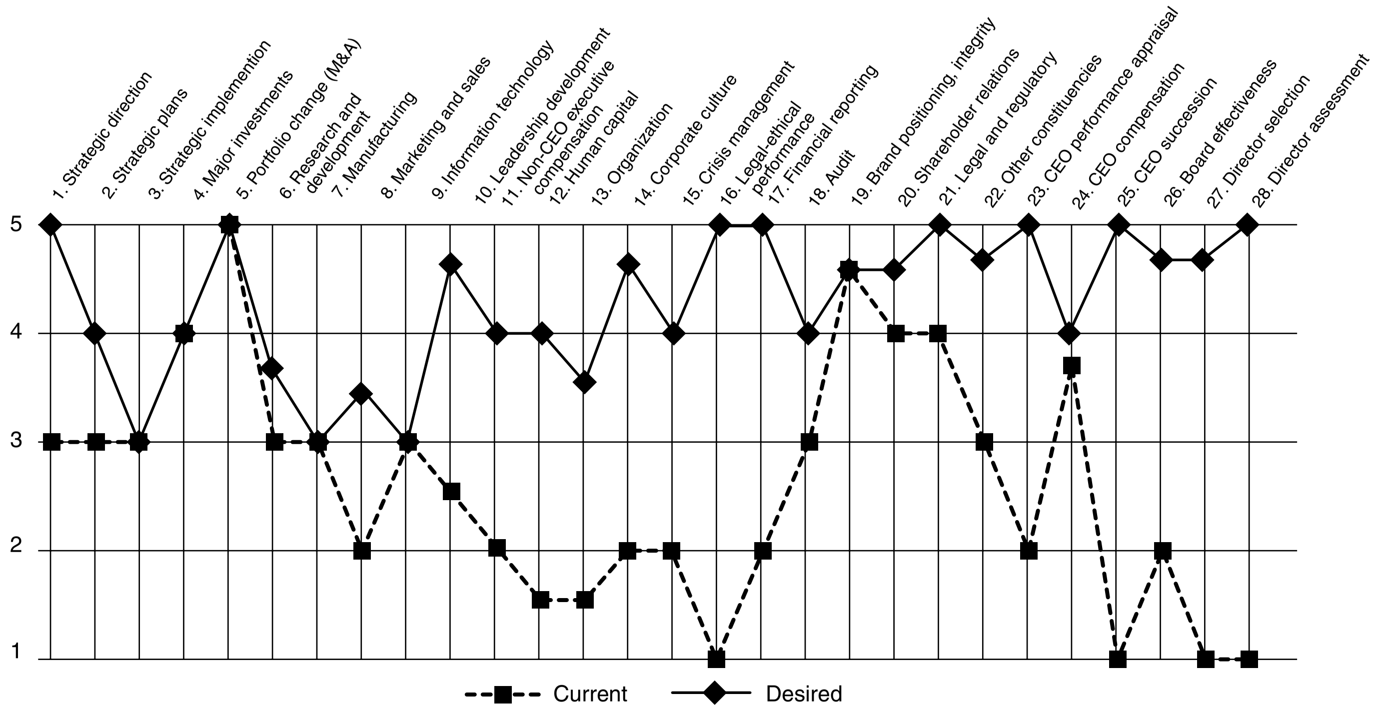

Figure 1.3. Areas of Potential Board Engagement: Current Versus Desired.

First, the fundamental issue on the table is appropriate engagement. So far, our discussion has been fairly abstract in that we've been talking about engagement in terms of defining the respective responsibilities of the board and senior management. But as we work through the framework, it will quickly become evident that there's nothing abstract about it.

In Chapter Two, for example, as we discuss the board's composition, one of the central issues will be what role the board, its committees, and its leaders should play in the recruitment, vetting, and selection of new members. Until fairly recently, most CEOs in the United States were basically free to pick and choose whomever they wanted to fill the seats around the table, and appointments were routinely used to pack the board with management allies and a couple of celebrities who might or might not have any qualifications for the job. Clearly, boards are quickly assuming much of the responsibility for selecting members. But that leaves open the important question of what role, if any, the CEO should still play.

We'll see that same question played out as we move through the board's internal work processes (such as agenda planning and information management) to specific content areas such as development of corporate strategy, CEO performance evaluation, and succession planning. In each case, the work has to begin with some shared vision of the respective roles of the board and management.

The second theme is that process really is important; sometimes, it's what is most important. It's not enough to say that the goal is a board that is active, engaged, and functioning as a high-performance team. The processes employed by board leaders have to model the culture they hope to create. You can't mandate a culture of engagement. You can't have two or three senior directors go off on their own and set the ground rules for broad participation. You can't order members to think and act independently.

In short, the culture the board wants to create has to be reflected by, and consistent with, the processes it uses to achieve that goal. Board-building is about more than what work the board chooses to do; just as importantly, it's about how the board chooses to do that work.