THE STRUCTURE AND SUCCESS OF THE BOARD OF DIRECTORS

CEO Eleanor Bloxham discusses the roles and responsibilities of company board members.

ELEANOR BLOXHAM, INTERVIEWED BY PAUL SHARMAN

Often, people who work in groups have a hard time reaching decisions collectively, and they can be hindered by differences in opinion regarding priorities. What follows is an interview with Eleanor Bloxham, CEO of The Value Alliance and Corporate Governance Alliance, focusing on the effective operation of the board of directors and other decision-making bodies that are comprised of multiple unique personalities and ideas. Eleanor also discusses the responsibilities of the individuals serving on the board and the best ways to overcome common obstacles.

Paul. How do the human dynamics on boards differ from, say, working for a company?

Eleanor. There's something more intimate about the human dynamics on a board than working for most companies. Think about a seminar in college with 12 people versus a lecture hall with many. If you have ever worked in a small isolated group within a company, you know that the dynamic is different from situations in which you interact with many people across the company or outside it.

But even though there are similarities, the dynamics of working in a small isolated group in a company differs from the dynamics on most boards because of the way the work is structured. In the company setting, you show up every day. Unless you work virtually, most of your work occurs on company premises, and you really get to know the other members of the team through daily interaction.

Board members who take their jobs seriously work much harder outside the boardroom than in it. This work involves more than the 300+ pages of information provided by management for the directors to read and digest before each meeting — or the briefings management sends daily, weekly, or monthly, depending on the company. Good directors spend significant time on their own doing self-study related to the company and its industries: reading analyst reports, sit-

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ting in on quarterly analyst conference calls, reviewing news and regulatory filings, attending industry conferences, and keeping up with regulatory and accounting changes.

Depending on the type of company, the work may involve visiting the company's stores or restaurants and those of its competitors or visiting the company's worksites or plants. Good board members also study the industry challenges faced by major suppliers and customers and by the country managers where the company is located.

A board might meet in person six times a year for two days each, plus a three-day retreat once during the year. That's 15 days all year long. Yes, they'll get to know each other but not quite as well as 12 people working with each other every day, day in, day out. Some boards schedule social times as part of the board's activities, or board members do this on their own to develop good relationships.

Compensation is another way in which board and corporate work differs. If you work for a company, you likely derive most of your income from this work rather than other sources of pay. The same can be true of some board members, but for many it is not. They tend to have some combination of a well-paying day job or retirement funds and several board seats. Their eggs aren't all in that one basket. Plus, it's likely if you work for a company, you don't get to sit around with your colleagues and decide if you are due a raise and then make it happen. Board members do.

Companies tend to have established hierarchies within the organization. There's an organization chart. Whether you report directly to a single person or indirectly to more than one (the whole dotted line, matrix idea), when asked who your boss is, it's someone even the CEO can point to. In her case, it's the board.

Paul. Do boards, or should boards, have a hierarchy?

Eleanor. No. A board should really act like the Knights of the Round Table — equal votes and self-governing. It's the highest governing body of the corporation, and the idea is that power should not rest with one person, that there should be a diversity of thought brought to the oversight function of companies.

Now if you think about it, this is what makes having CEOs or other executives on the board problematic. In the U.S., the top executive often doesn't sit on the board in tax exempt organizations, but in most taxpaying organizations, the CEO is a board member. The CEO is the board's hired hand. One of the primary responsibilities of the board is to hire and fire the CEO and decide her paycheck. So there is a hierarchy, and there should be. The CEO's main function is being CEO, and for the CEO to sit on the board just confuses the matter. More importantly, it can also cause the board to tiptoe around issues because, as a board member, the other directors are prone to view the CEO as being on equal (or higher) footing. If other executives are on the board, there are similar problems. In this case, the CEO is the primary evaluator of their performance. There is no way they are exactly equal members.

Over the past 10 years or so, many more U.S. corporate boards have begun to understand that the hired hand, the CEO, should never be the board chair. But not all. Through my board work I have seen the role confusion that occurs when the CEO is also the board chair. Board members don't know when to kowtow because she's the chair or when to oversee her because she's the CEO. Some people say a lead director or presiding director position cures the problem, but it really doesn't. Board members remain confused. The independent board members should choose the chair from among their independent peers.

GOOD BOARD MEMBERS STUDY THE INDUSTRY CHALLENGES FACED BY MAJOR SUPPLIERS AND CUSTOMERS AND BY THE COUNTRY MANAGERS WHERE THE COMPANY IS LOCATED.

Of course, even if they aren't members, the board is going to want the CEO and other executives to attend most of the meetings to provide input. But to sit on the board? To have an equal vote on board decisions? No — and I'm not alone in thinking this. John M. Nash, founder

and president emeritus of the National Association of Corporate Directors, the largest organization of independent directors in the U.S., has been saying this for years.

Paul. How can boards reach an informed agreement on the most important things to do and then stay on track to do them?

Eleanor. Boards first need to develop and agree on well thought out corporate governance guidelines or principles that outline the role of the board, its purpose and activities, responsibilities and accountabilities composition, qualifications for membership, and how it will operate. Some boards do this well, but some do it very poorly.

Goldman Sach's corporate governance guidelines miss the boat in several ways. One is by not making a clear distinction between the roles of the board and the roles of the independent board members. For example, the guidelines state, "The board shall be responsible for establishing and maintaining the most effective leadership structure for the company" and "the board shall review its leadership structure at least annually." But the management members of the board and the non-independent directors shouldn't be involved in these processes. (Currently Goldman Sachs combines the CEO and chair positions.)

The guidelines also state, "The invitation to join the board shall be extended by the board via the chairman and either the chairperson of the governance committee or another independent director of the company designated by the chairman and the chairperson of the governance committee." But because the CEO is the chair, this is a real governance no-no. Since when does the caterer invite the host to the party?

To its credit, Goldman Sachs has updated sections of its guidelines. In a March 2012 article published by *Fortune,* I wrote about a number of problems in the company's governance guidelines. One problem was a section that said the CEO would play a role in agenda-setting by being asked "to identify matters for discussion at executive sessions of the independent directors." That is an inappropriate role for the CEO. Today, a better process is in place according to the latest guidelines. Now the guidelines say that the lead director shall "[engage] with the other independent directors to identify matters for discussion at executive sessions of the independent directors."

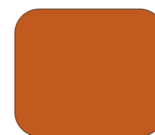
In the March 2012 article, I also took issue with a guideline that the lead director would be "reporting to the chairman and CEO any views, concerns, and issues of the independent directors" after each executive session. At the time, I wrote,

> A blanket requirement to report is not in the best interest of the board's independence and may, in fact, stifle rather than foster communication among the independent members. The lead director should not be making such a report unless the independent directors agree. There could very well be sensitive matters that the independent directors may wish to form an opinion on before they discuss them with the CEO — and the independent members at least should have an opportunity to weigh those options.

In the current version, the board has cleaned up the language to say that the lead director will be "advising the chairman of decisions reached, and suggestions made, at such executive sessions, as appropriate."

You can tell if a board is clueless about governance when you see poorly developed guidelines or find out the members haven't even read them. Drafting these guidelines isn't work that should be delegated to legal staff at the company. The guidelines represent one of the important documents that the board should live by. Independent board members should take an active role in writing them. The document should specify the standing committees of the board, and it should be reviewed, discussed, and updated by the board annually.

Boards also need to develop clear, complete, detailed charters for their standing committees (like the audit committee, the compensation committee, and the governance committee). The charters should spell out the qualifications for independent committee members and detail the responsibilities of the committee, including reporting responsibilities to the board. The charters should specify what decisions the



BOARDS FIRST NEED TO DEVELOP AND AGREE ON WELL THOUGHT OUT CORPORATE GOVERNANCE GUIDELINES OR PRINCIPLES THAT OUTLINE THE ROLE OF THE BOARD, ITS PURPOSE AND ACTIVITIES, RESPONSIBILITIES AND ACCOUNTABILITIES COMPOSITION, QUALIFICATIONS FOR MEMBERSHIP, AND HOW IT WILL OPERATE.

board has delegated to the committee, making clear the decisions the board retains for itself and in which capacities the committee acts as an advisory body to the board. As with the corporate governance guidelines, the committees and the board should review, discuss, and update their charters annually — all with approval from the independent board members.

In too many instances, committee charters are confusing with overlaps in responsibilities between the committees, making accountabilities unclear. This can make simple duties more difficult to execute. The individual charters need to specify how the committee will work with other relevant board committees. For example, determining CEO pay might be the job of the compensation committee, but its charter might specify that the audit committee will verify the financial metrics used to determine the CEO's pay. Similarly, the audit committee charter would outline its responsibility in providing sign-off on the financial metrics to the compensation committee.

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Sometimes boards create ad hoc committees to consider particular matters, such as making recommendations to the full board on a restructure, a sale, an investigation, or an acquisition. Boards need to write clear charters for these committees also. Failure to be clear on the authority, responsibility, independent qualifications, and accountability of these committees and on the decision-making authority to be retained by the board can result in causes for legal action by shareholders and others.

The board should maintain the charter for the ad hoc committee throughout the committee's life, and if circumstances require changes to the committee's charter due to changes in the scope of the ad hoc committee's original assignment, the board should discuss and document any changes by updating the charter. This can occur, for example, in the case of an investigation when new information is learned and the scope of the investigation expands, perhaps requiring additional resources or even changes in the ad hoc committee's composition if conflicts of interest arise. Say, for example, it turns out there was unanticipated financial malfeasance. If the ad hoc committee includes a member of the audit committee who signed off on the financials, the ad hoc committee might need to reconstitute itself by replacing the audit committee member with a more independent board member.

Every board should have an annual and multi-year calendar for the board's work and that of the committees. The calendar specifies when the board will address the duties it has outlined for itself. The calendar ensures that the board stays on track in following through on its most important responsibilities, especially those required by law or fiduciary obligations.

For some boards, the calendar includes scheduling an annual strategic retreat to perform an in-depth review of the company's strategy. This may be supplemented by individual reviews of each major business at particular meetings during the year. Or to perform its work on succession, the board may schedule dinners, meetings, or site visits to meet with succession candidates and schedule discussions of various kinds to discuss talent and development issues.

This calendaring should occur at the committee level as well. Think about the Lehman board's risk committee. It only met twice one year when a well thought out charter and calendar would have argued for many more meetings.

In the example of CEO pay and financial metrics, the audit committee needs to know when to provide agreed-upon metrics to the compensation committee and make that part of its calendar.

In the last decade since Enron and WorldCom, many audit committees have implemented structured processes to ensure they follow up on their accounting-related responsibilities by using a calendar. But the challenges of audit committees are greater than they were a decade ago. Audit committees could benefit from expanding the items on their calendars to reflect the new realities of cyber and social media risks and other operational control issues.

Compensation and governance committees benefit from forward-thinking structures that give weight to both big picture discussions and detailed to-dos. Too many discussions are rushed; as a result, many boards continue to receive unfavorable press and shareholder proposals on compensation and governance matters.

Agendas are another mechanism to encourage boards to stay on track. The starting point is to translate the calendar items on to the individual agendas for the board and its committees. The agenda should also include other items board members think are important to discuss. All board members should be encouraged to contribute to the agenda-setting process.

In setting its meeting schedule, the board should allow ample time for meeting and discussion. As much as possible, all board time should be devoted to discussion. Board members should read presentations and other materials in advance. This allows the time in the meetings to be used to thoroughly address the matters the board believes to be most important.

Another way to stay on track is for the board to conduct an annual review of its own performance. The review should answer such questions as: Do we agree on the most important things we as a board should be doing? Did we stay on track and do them? Using an independent outsider to guide the process extracts the most candid responses as well as provides independent suggestions. The board should use the annual performance review to refresh its informed agreement on what is most important and outline its path forward for the upcoming year.

So those are some of the basic processes every board needs, but how does the board get to an informed agreement on what is most important? First, they must set this as a priority and see it as a responsibility of the board itself to undertake this work. To do that you must have the right people on the board, and that's the job of the nominating and governance committee.

BOARD MEMBERS NEED TO HAVE RESPECT FOR ONE ANOTHER.

Paul. What are the roles of the board and committee chairs?

Eleanor. The independent board members should appoint the committee chairs and set out the requirements for their roles. There should be written job descriptions, and the independent directors should evaluate the effectiveness of the board and committee chairs. It's a good practice for the board to periodically rotate people in these roles to make sure they have backup and get new thinking into the role.

The chair of the board typically has a convening role: to call meetings, to make sure all the directors have input into the agenda, to oversee the meetings, and to make sure everyone participates and speaks up. The good board chair will tease out the issues requiring attention, making sure the elephant in the room gets addressed. A great business and people leader makes a good chair — one who encourages the devil's advocates. At the same time, you really need to have someone who is diplomatic and can bring people together. I often think, in this case, of former U.S. Senator George Mitchell, who helped ease tensions in Northern Ireland and also did the same on the Disney board. The chair is often a coach to the CEO, so those skills are important.

Paul. Which human dynamics and attributes most facilitate well-functioning boards and which prevent boards from achieving their goals?

Eleanor. Board members need to have respect for one another. You want people who are open yet tactful, smart and courageous, willing to speak their mind and take a stand when needed. Egos can be a problem, and the "wallflowers" who don't contribute can also be a problem.

To serve on a board effectively, people need to have a high emotional IQ and be flexible thinkers. Their leadership skills need to be so strong that they can exercise the appropriate behaviors for the context. Individuals who need handholding don't do well — nor do "know-it-alls" or people who need approval. You have to love to read, analyze, and

review spreadsheets and be willing to do the homework. You have to be tenacious. You have to put in the time and focus.

Paul. How can boards overcome the human elements that most tend to stymie them?

Eleanor. In addition to what I've already emphasized, there are two keys: a great director-hiring process and a great process for keeping the board refreshed. For boards, letting someone go is often the hardest part, but this is what separates the toy boards from the real ones. Boards need to take a hard look at themselves in this regard — this is where the rubber meets the road. I like the requirement Richard Breeden imposed on WorldCom following the accounting debacle: One person per year leaves the board. This is a great way to keep directors on their toes.

Paul. Other thoughts on boards and their human dynamics?

Eleanor. Boards are as dysfunctional as any other human organization. The reason the topic is important is because board actions and inactions affect the lives of so many people. Boards deserve the scrutiny they are getting. When things go awry, you can bet it comes down to human dynamics — not doing the job, not discussing the important issues. In the end, it all comes down to human foibles. ■