
IMPROVING CORPORATE BOARDS

THE BOARDROOM INSIDER GUIDEBOOK

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THE BOARDROOM INSIDER GUIDEBOOK

RALPH D. WARD



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To Maud and Ada—and their limitless futures.

About the Author

Ralph D. Ward, publisher of *Boardroom INSIDER* newsletter, and editor of *The Corporate Board* magazine, is a nationally recognized writer and commentator on the roles of corporate boards of directors and corporate governance.

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The Boardroom INSIDER Checklist for M&A and Subsidiary Boards

The Boardroom INSIDER Checklist for Nonprofit Boards

The Boardroom INSIDER Checklist for Global Board Issues

Foreword

What are the attributes of a truly effective board of directors? What are the hallmarks of an excellent board member?

As we enter a new century, these two questions are at the core of a much broader and often fierce debate about the responsibilities of a board and its directors. For decades, of course, most boards had become little more than internal fan clubs for the boss. Friends and cronies were often invited on as directors to support and stroke the chief executive and to help him network his way through a challenge or problem.

The near-meltdown of many large American enterprises in the 1980s, however, caused many boards to test and question the chief executive. In some cases, including American Express and General Motors, boards pushed out poorly performing bosses. Institutional and activist investors helped to place pressure on board members for reform and action. As a consequence, the media began to focus greater attention on boards. As a senior writer for *Business Week* magazine, for example, I created a best and worst list of boards that debuted in 1996.

One very positive fallout: The uproar and the attention has made many far more interested in boardroom practice and procedure. At small and large companies, and at nonprofit organizations, the directors who sit around the long, highly burnished tables increasingly want to improve their performance. They do not want to be perceived as a cozy, clubby group of the chieftain's friends. Rather, they want to play a more active and vital role to help their companies succeed. They also want to fulfill their fiduciary responsibilities to shareholders and other stakeholders.

Yet, boards must resist the temptation to become over-involved in a company's affairs. So where to draw the line? The book in your hands provides much nitty-gritty counsel on how to discharge your

duties as a director in this new more active model of governance. What involvement should the board have in corporate strategy, succession, and performance evaluation? How should a board organize its various committees? What should you do in-between board sessions to fulfill your job as a valuable board member? How can you edge out a nonperforming board colleague? You'll find useful tips in these pages from some of the best directors and boards in Corporate America.

What I find most refreshing, however, is that author Ralph Ward does not take a dense, academic approach to dispensing advice and help. Instead, his numerous examples and lessons, many culled from his online newsletter, are easy-to-read and highly accessible. Even better, there are lots of ideas in this book that can immediately be carried into the next board meeting to make one a better director.

John A. Byrne
Senior Writer
Business Week

Preface

The growth in corporate governance as a business issue over the past decade has been astonishing. In 1990, even the most savvy business observers could not name any of the outside board members of our top corporations. How these directors were elected, for what terms, how independent they were, how much they paid themselves and the CEO, and the quality of their oversight were *terra incognita*. The greater business community knew little and cared less.

In the year 2000, however, *The Wall Street Journal*, *Business Week*, and the top cable business news programs routinely drag boards into the spotlight. CalPERS produces a yearly list of America's best and worst boards, and gains a level of news coverage once reserved for Mr. Blackwell's Worst Dressed List. The media study the board rumblings at troubled corporations like DaimlerChrysler, Waste Management, AMD, and Compaq with the care they once devoted to the Soviet Politburo. The New York Society of Security Analysts and Georgeson Inc. publish closely studied tips on how a company's governance should be factored into analyzing its prospects and into investor relations.

Globally, reports on corporate governance, such as Cadbury in the United Kingdom and Vienot in France, have become living documents that shape national policy on how companies are regulated and managed. U.S. observers such as the National Association of Corporate Directors and the New York Stock Exchange are now crafting "best practice" governance policies that drive corporate laws and regulations. Recent transnational guidelines from the Office for Economic Cooperation and Development are stirring a truly global movement for a new, international governance agenda.

Yet the story of *how* governance grew to this eminence, and the way it was shaped (and was itself shaped) by current thinking on the issues, is less well known. In 1990, corporate governance was an esoteric subject of interest to a small handful of business observers, primarily shareholder activists and business school academics.

The early activist voices were primarily progressive change groups, though a few state pension funds were also involved. These advocates usually brought a narrow, cause-based approach to governance. They may have raised a proxy stir, showing up at annual meetings to “just vote no,” but they weren’t too worried about what happened in the boardroom, except as it advanced their goals. Disinvestment from South Africa, pollution, nukes, or affirmative action set the activists’ agendas—not how well the board did its job.

Indeed, the company’s board was viewed as such a remarkably gray and tedious affair that it served as its own camouflage in these battles. At annual meetings (the only time anyone actually saw the board) directors were little more than a restive audience, wishing the chairman would hurry the hell up, switch off the gadfly’s mike, adjourn, and move on to lunch. The activists, meanwhile, largely wrote off the ho-hum governance issues, assuming that they’d score more points through the sound bites they gave the media after losing their proxy vote eight million to three.

The other voices concerned with governance a decade ago were far quieter, heard mostly in academic journals or the *Harvard Business Review*. Academics and authors such as Jay Lorsch and John Pound offered early insights into the power that actually resided in the boardroom. They shaped valuable models and rationales for how the board could counterweigh management, and the forces that influenced governance. But the academics brought an empirical treatment to the wildly subjective world of the boardroom. Their careful methodology charted how such factors as director independence, separate CEOs and chairmen, and greater board diversity affected results. Yet at the same time, companies whose boards broke all such rules were often just as likely to be making bank.

But the issue of corporate governance saw a massive topical uplift in the early 1990s. The recession of 1990–1992 led to a headline-making series of CEO sackings in the United States. In the United Kingdom the first Cadbury report in 1992 sparked a trans-European drive for governance reform. Corporate governance and the dynamics of

the boardroom suddenly *mattered* in business, at the same time as business news itself was taking off.

We've all seen how the news media scrambles for any information it can grab on a topic when world-class news suddenly bursts forth from obscurity. Likewise, the business world and the business media seized on the state of governance as it stood at the moment for its archetypes. Academia and activism thus became the progenitors of what we now know as the American corporate governance movement.

As with any active, fast-growing family, the offspring of these governance parents introduced their own variations. The governance activists begat major pension funds, mutual funds, relational investors, and proxy advisors—entities with business agendas as radical as you'd expect from their names. These institutions largely supplanted social statements with focused concerns on shareholder value. Today their governance initiatives tightly target the bottom line, focusing on such issues as antitakeover protections, board responsiveness to shareholders, and share price.

The academic wing has continued its research, providing statistical tools that help the governance voices prove their points. Crossing into the world of governance consulting, however, the academics have provided valuable assessments of the little-studied governance landscape. They've made careful case studies of how boards handle major issues, compiled much-needed historical data on board evolution and structure, and dragged business leaders into an appreciation of how serious governance issues can be.

But there's been a price for building this new governance phenomenon on the old activist/academia foundations. Both of these strains have "outside-looking-in" roots when it comes to what really happens in the boardroom. The activists and funds approached governance as a tool to achieve their agendas. The tools have become more effective, shrewdly forged, and precisely used, but they still approach board improvement as a means to their own ends. Even when the end is better shareholder value, definition of the term is so debatable that boards are often right in questioning the activists' one-size-fits-all prescriptions. A corporate board is still no more likely to believe someone saying "I'm from CalPERS, I'm here to help you" than they are anyone else from the government.

The academic/consulting strain, meanwhile, offers sound macro information for what are often micro issues. Good statistics on how

board independence influences company performance sound valuable until we consider how wildly subjective and debatable any definitions of “independence” and “performance” really are. Furthermore, the academics often disagree among themselves on governance. Over the past decade, researchers have provided solid, empirical evidence that board independence improves shareholder value; that board independence has no effect on shareholder value; and that board independence turns CEOs into boardroom Machiavellis. Such high-altitude views of governance also divorce themselves from the very untidy world of “boardsmanship”—how a group of high-powered individuals sit around a table and take practical action.

Worse, as the worlds of business school and consulting firm feed on each other, governance begins to suffer from the same consultant buzz-term voodoo that has proved of such dubious value to management. The best we can say is that, when we combine the 1990s stock runup with the huge growth in consulting and business publishing, both the activists and the academics have spent the past decade making tall dollars.

In short, when it comes to offering solid advice for running a better board, the current American field of corporate governance either misses the mark or aims at the wrong target.

In 1997, I launched the online newsletter *Boardroom INSIDER* as a response to these needs. In speaking to groups on corporate governance, I found that the people who actually serve in our boardrooms ask specific types of questions. They aren't fretting over how to differentiate shareholder from stakeholder needs; whether it's proper to combine the jobs of chair with that of the CEO; or what the big institutional investors think of them. Instead, they want to know the nuts and bolts of making board evaluation work. They want to know how to discreetly edge inept, lazy members off their boards. They seek advice on the intense, personal political issues that arise behind boardroom doors. And they want to know how to do more and better board work in less time.

This boardroom folk wisdom exists, alright. There are thousands of seasoned, wise board pros out there, Jedi Knights of governance with invaluable boardroom experience. But their knowledge is widely diffused, hidden in bits and pieces, and almost wholly uncollected. Directors and boards were left to reinvent the wheel time and time again, in an environment where trial and error is a very expensive

teacher. A valuable tip for using the board as a recruitment tool would filter out of the boardroom at Company X slowly, if at all, and might never be learned by Company Y, headquartered in the same city.

And even the savviest of board pros don't know everything. In editing *Boardroom INSIDER*, I've chased the answer to some puzzling governance questions by calling a half dozen proven board experts, only to find them stumped. Then, on the seventh call, someone with equal qualifications will come up with an answer—with the bland assurance that the issue is hardly worth pursuing because “*everybody* knows that.”

But everybody *doesn't* know, and that's the reason for this book. The book is a compilation of the best information offered over the past couple of years in *Boardroom INSIDER*, organized under the most commonly sought topical headings. This book makes no claim to be a comprehensive treatment of what you need to know to run the “complete board”. Indeed, in the compilation process, I developed a number of new items specifically because some topics needed fleshing out. Also, as with any endeavor based so extensively on reader questions, a missing item may simply mean that no one has asked about it—yet.

And that, possibly, is the ultimate problem we face today in improving the quality of our corporate boards. Worse than what our directors don't know, or what they don't do right, is our assumption that they already know all the answers. But when these directors *don't* know all the answers, they can't very well admit it, since they're already supposed to be the experts.

Consider this book a first step in addressing this problem. The boardmanship answers it provides will be of real value to your directors. But this book will be even more valuable if it makes it okay for them to ask questions in the first place.

About the CD-ROM

Introduction

The forms on the enclosed CD-ROM are saved in Microsoft Word for Windows version 7.0. In order to use the forms, you will need to have word processing software capable of reading Microsoft Word for Windows version 7.0 files.

System Requirements

- IBM PC or compatible computer
- CD-ROM drive
- Windows 95 or later
- Microsoft Word for Windows version 7.0 (including the Microsoft converter*) or later or other word processing software capable of reading Microsoft Word for Windows 7.0 files.

*Word 7.0 needs the Microsoft converter file installed in order to view and edit all enclosed files. If you have trouble viewing the files, download the free converter from the Microsoft web site. The URL for the converter is: <http://officeupdate.microsoft.com/downloadDetails/wd97cnv.htm>.

Microsoft also has a viewer that can be downloaded, which allows you to view, but not edit documents. This viewer can be downloaded at: <http://officeupdate.microsoft.com/downloadDetails/wd97vwr32.htm>.

Note: Many popular word processing programs are capable of reading Microsoft Word for Windows 7.0 files. However, users

should be aware that a slight amount of formatting might be lost when using a program other than Microsoft Word. If your word processor cannot read Microsoft Word for Windows 7.0 files, unformatted text files have been provided in the TXT directory on the CD-ROM.

How to Install the Files onto Your Computer

To install the files follow these instructions:

1. Insert the enclosed CD-ROM into the CD-ROM drive of your computer.
2. From the Start Menu, choose **Run**.
3. Type **A:\SETUP** and press **OK**.
4. The opening screen of the installation program will appear. Press **OK** to continue.
5. The default destination directory is **C:\WARD**. If you wish to change the default destination, you may do so now.
6. Press **OK** to continue. The installation program will copy all files to your hard drive in the **C:\WARD** or user-designated directory.

USING THE FILES

Loading Files

To use the word processing files, launch your word processing program. Select **File, Open** from the pull-down menu. Select the appropriate drive and directory. If you installed the files to the default directory, the files will be located in the **C:\WARD** directory. A list of files should appear. If you do not see a list of files in the directory, you need to select **WORD DOCUMENT (*.DOC)** under **Files of Type**. Double click on the file you want to open. Edit the file according to your needs.

Printing Files

If you want to print the files, select **File, Print** from the pull-down menu.

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IMPROVING CORPORATE BOARDS

THE BOARDROOM INSIDER GUIDEBOOK

