Ending the Board Game
New Leadership Solutions for Companies

Recent events in corporate America have exposed some failings in the way most companies are led. When the CEO is also the chairman of the board, there is no effective system of checks and balances to ensure not only successful performance but also integrity. However, there are alternatives.

The accounting and fraud scandals at Enron, WorldCom, Global Crossing, Tyco, and other companies raise a critical question: why did their boards of directors fail to take a strong leadership role and preempt these disastrous outcomes? After all, a board has a legal responsibility for the management of its company. There are numerous reasons why the boards of these particular companies failed to take a proactive role, but one crucial contributor was the nature of leadership on corporate boards today.

Many current corporate governance policies and practices are intended to ensure a balance of power between the CEO and the directors, but reality usually gets in the way. Among the vast majority of U.S. companies, leadership is vested largely in the hands of a single individual—the CEO. But it’s becoming increasingly clear that relying on one person to lead both a company and its board can be a serious mistake. To halt the procession of corporate scandals, leadership needs to be shared.

INSIDE KNOWLEDGE
If you look closely at today’s boards, you’ll see that in most cases the CEO is the unquestioned leader. This is largely because of the natural advantages of the CEO’s position.

For one thing the CEO has far greater access than other directors to current, comprehensive information about the state of the company. The other directors usually have extremely limited knowledge of company affairs. Their enlightenment is restricted by the fact that they usually

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are company and even industry outsiders with a part-time role. Although their external perspective has some important advantages, it is a liability when it comes to cultivating knowledge and information about the company and its industry. Most directors are well aware of this gap in their understanding and, as a result, willingly concede authority to the CEO.

Directors also tend to see their primary role as serving the CEO; to them, providing oversight is a secondary role. Most directors are CEOs themselves, so they share an unwritten but binding etiquette that frowns on aggressively challenging a fellow CEO and on probing too deeply into the details of someone else’s business. Many fear that they will end up micromanaging CEO responsibilities. All these factors encourage directors to defer to the leadership of the CEO.

As a result the CEO usually determines the agenda for meetings and controls the type and amount of information that directors receive. The CEO often is the one who selects board members and appoints the members of the board’s various committees. These and other powers and prerogatives generally make the CEO the de facto leader of the board. The only exceptions—the only times when a board feels it must take the lead—typically come during the selection of a new CEO or during a change of company ownership.

**DUAL TITLES**

The CEO’s effective leadership of the board is magnified and solidified in most companies by the fact that the CEO is the leader not only in essence but also in name—he or she is the board chairman. From a CEO’s vantage point, there are clear positives to this dual leadership role.

- It centralizes board leadership and accountability in a single individual, so there is no question about who leads the board.
- It eliminates the possibility of a dysfunctional conflict or rivalry between the CEO and the board chairman, which might result in ineffectual compromises and drawn-out decision making.
- It avoids the potential problem of having two public spokespersons addressing the organization’s stakeholders and possibly delivering conflicting messages.
- It achieves efficiency in that the board chairman is also the person who is most informed and knowledgeable about company affairs. The CEO doesn’t have to spend a lot of time and energy on updating a board chairman on company and industry issues before each meeting.

For companies there may be another advantage—at least in the current environment—to combining the roles of CEO and board chairman. Research has shown that CEOs, almost without exception, strongly believe that they should also hold the chairmanship of the board. When it comes to recruiting the best CEO talent, companies whose policy is to hand the reins of the board to the CEO are therefore likely to have an advantage over companies that don’t have this policy.

Superficially, at least, it appears that there are a number of advantages to having the CEO and the board chairman be one and the same. But there is a critical drawback to relying on this CEO model of board leadership—a drawback that has become painfully evident during the recent corporate scandals. Under the CEO model, too much leadership authority is concentrated in the hands of the CEO, and the company often has no effective system of checks and balances when it comes to leadership.

One way to balance power is to create another source of leadership, and organizations have at least three options available to achieve this: an independent, nonexecutive chairman (someone from outside the organization who has never held the CEO or other executive position in the company); a lead director; or strong, autonomous board committees.

**SPLIT DECISION**

The idea of a separate, nonexecutive chairmanship has been circulating for at least a decade. Few companies, however, have adopted this option—only about 10 percent of the largest firms in the United States have a chairman who is not also the CEO. This suggests fairly strong resistance to the concept among the top echelons of corporate America.

What are the arguments for having a separate, nonexecutive chairman? Perhaps the principal one is that it increases the ability of the board to monitor the CEO’s performance. A board led by a fellow director will likely feel it has greater latitude to challenge the CEO and his or her actions when necessary. In addition, having a separate board chairman may enhance a company’s standing among investment fund managers, who often assume that CEOs seek to serve themselves first and shareholders only secondarily. In the eyes of these fund managers, a separate, nonexecutive chairman with a mandate to elevate shareholder value is less likely to be compromised than a CEO-chairman.

There are a number of qualities and characteristics that a separate chairman should possess to be effective and...
successful. First, the chairman should not be a former CEO of the company. (A former CEO would likely have been involved in the selection and often the mentoring of the current CEO, so his or her objectivity could be compromised.) Second, the chairman should have the confidence and admiration of the directors, along with self-confidence and sufficient knowledge of the company and the industry to fit naturally into the leadership role. To gain this knowledge, the chairman must be dedicated to putting in the time and effort to closely follow the company and its industry.

This requirement means it’s not a good idea for the outside chairman to be a board member or CEO of another company (although a recently retired CEO might fit into the role perfectly). Being a separate, nonexecutive chairman can be highly demanding—in large, diversified companies the chairman may need to spend seventy-five to a hundred days a year keeping abreast of the company if everything is going well, and even more if the company encounters a crisis.

Because the separate chairman will work closely with the CEO, it’s important that the CEO be involved in the selection process. For this model of board leadership to function effectively, the chairman must feel that his or her allegiance is not solely to the CEO and must feel free and unafraid to challenge the CEO. At the same time, there should be strong positive chemistry between the two individuals—again because they will be working together so closely. However, the chemistry must not be so powerful that it could override the chairman’s objective viewpoint.

During the selection process, it’s best if the chairman candidate and CEO decide for themselves whether chemistry exists between them. However, the scope of the potential chairman’s ability to challenge the CEO is best determined by the sitting directors. In light of this, the best selection method is for the CEO to provide his or her input on each candidate on the roster submitted by the board nominating committee and then for the board to make the final choice.

Establishing from the start clear and negotiated expectations of the roles the separate chairman will assume is also critical to the success of this model of board leadership. Tasks and responsibilities to be placed under the purview of the chairman might include setting meeting agendas in consultation with the CEO; assigning tasks to board committees; facilitating full and candid deliberations of matters that come before the board; and annually reviewing the board’s governance practices.

Despite the potential that this board leadership model holds for breaking up the concentration of authority and reducing the chances of scandal, it’s unlikely to be widely adopted by U.S. companies. The primary stumbling block is CEOs themselves. As noted earlier, most CEOs are strongly biased toward having a single leader—themselves. They believe that sharing leadership of the company and the board is cumbersome and inefficient. In addition, candidates for the role of separate, nonexecutive board chairman face greater legal risks than other directors do—risks for which they might not be willing or able to get liability coverage. Moreover, they must be willing to make a much greater time investment than that required of a typical board member. For most people who would be considered qualified outside candidates, such an investment would be impractical.

There are strikes against the nonexecutive chairman form of board leadership, but companies looking to break away from the status quo have two other alternatives to consider.

**PROCESS PILOT**

A form of board leadership likely to be more palatable to many CEOs is having a lead director—an individual who does not assume the formal role of chairman but acts as the directors’ representative to the CEO. Through this intermediary function the lead director can bring to the CEO sensitive issues or concerns that individual directors might not raise on their own or want discussed in a public forum. In this alternative the lead director leads not so much in the sense of influencing the board’s stands on various issues as in the sense of piloting the boardroom process.

The lead director is both an ombudsman and a facilitator of the governance process. His or her role can include overseeing and preparing the agenda for board meetings, discussing controversial business issues one-on-one with the CEO, and conducting exit interviews with executives who are leaving the company to determine whether their resignations reflect problems in the organization or with the CEO’s style and approach. In addition, lead directors might meet on occasion with major shareholders to determine their expectations and concerns. Such smaller meetings, without the presence of company management, could encourage more open, revealing, and helpful discussion than occurs at annual, public shareholder meetings.

What characteristics should be sought in a lead director? In addition to being from outside the organization, the ideal lead director should have significant executive experience, should be highly respected by
other members of the board, should serve in another board leadership capacity (as chairman of a board committee, for example), and should possess the strength of personality and background to effectively challenge the CEO when warranted. The lead director should not be selected on the basis of seniority on the board; although boards are prone to honor an elder member with the lead directorship, this criterion is often unlikely to be a good indicator of an individual’s ability to lead effectively in a changing business environment.

The lead director model of board leadership looks like an attractive alternative to leaving power solely in the hands of a CEO-chairman, yet less than one-third of the Fortune 1000 companies have opted for it. Many CEOs—and indeed, many board members—continue to believe that having a lead director merely gums up the works and is appropriate only in times of emergency. However, CEOs tend to be more amenable to the idea of the third option—giving board leadership to the board committees.

**MAKING HEADWAY**

Board leadership that is shared by the board committees has emerged as the most prevalent alternative to the CEO-chairman model. There are a number of reasons for this shift in power, but one of the most obvious is that CEOs, caught up in setting corporate strategy and overseeing day-to-day operations, realize that they have their hands full and don’t have the time to be active members of each board committee. As a result, they often feel comfortable in assuming a consultative or advisory role and allowing the committees to lead themselves—and by extension to lead the board as a whole.

The growing use of board committee leadership has also been driven by the increased reliance on outside directors, who of course become committee members and chairmen. With the proliferation of outside directors, the practice of CEOs’ hand-picking committee chairmen has largely been replaced by a system in which committees select their own chairmen.

In companies that have elected to turn to board leadership by committees—at least on a trial or experimental basis—committee members should take a number of steps to ensure that their panels not only retain their leadership but also enhance it. For outside directors to take full advantage of their relatively newfound majority status on boards and committees, they often need to develop action plans and positions that are independently produced rather than dictated or guided by the CEO and senior management. Board and committee meetings and other activities are generally the only opportunities the directors have to accomplish this. So it’s important that some committee meetings be held without company executives present so the directors can discuss sensitive issues—such as those surrounding corporate performance and executive succession. These committee meetings also may be the only chance panel members have to arrive at strong positions that they believe are in the best interests of the company but may be contrary to the stated preferences of senior management.

It is critical that committees be able to meet on short notice when the members believe this is called for by an event such as a corporate crisis or rapidly developing change. It’s also important for committees to ensure that they have the ability to seek and retain outside specialists who can make objective assessments of the company’s operations—and that they can do so without the permission of senior management.

**WHAT’S AHEAD**

To date, strong leadership from board committees is the area in which the most progress has been made in achieving governance practices that provide more balance in corporate leadership. Considering the resistance to board leadership by a separate, nonexecutive chairman or a lead director, it’s probably also the area in which the most progress will continue to be made for the foreseeable future.

But certain trade-offs involved in relying solely on board committee leadership may make it fall short of being the best option of the three. When leadership is splintered across a number of individuals, there is no single director who takes comprehensive responsibility for the board and for ensuring that its activities are well coordinated and meet high standards of governance. There may be no central ombudsman to give the full board a collective voice. In addition, because committees have a narrow focus, they can at best shape only portions of the overall agenda.

All these drawbacks suggest that committee leadership is only a partial approach to building a method of board governance that is truly effective and optimal for the well-being of companies. In the final analysis the practice of using empowered outside chairmen or lead directors should be the means of countervailing the corporate leadership practice of putting too much power in the hands of one person. In companies, as in governments, an effective system of checks and balances is critical to ensuring both successful performance and integrity.