IN TOUCH WITH THE BOARD

A Russell Reynolds Associates Series

Leadership for a Changing World. One in a series of communications from the Russell Reynolds Associates' CEO/Board Services Practice, *In Touch with the Board* addresses best practices in board composition, assessment, succession planning and other critical corporate governance issues.

What Makes for a High-Performing Board?

In this issue, Russell Reynolds Associates' consultants Luke Meynell, Rae Sedel and the CEO/Board Services team discuss the definition and measurement of a high-performing board. The paper draws upon the team's experience in working closely with boards and upon the specific insights provided by the chairmen and chief executive officers of some of the United Kingdom's largest companies.

The forces at work:

As the UK Combined Code of Corporate Governance 2003 states: "Every company should be headed by an effective board, which is collectively responsible for the success of the company."

The scrutiny placed upon public company boards continues to intensify. Stakeholders—from regulators to shareholders to corporate social responsibility advocates—have become more vocal, more sophisticated and less forgiving, while the business environment has become more complicated and more competitive. In particular, three forces have combined to increase the pressure on boards:

- **Shareholders:** Both short-term and long-term investors are expecting boards to play a greater role in ensuring that shareholder value is maximised, and shareholders are quicker to issue challenges when they are displeased. The recent expansion of private equity to the acquisition and management of large companies has made this more acute, forcing boards to measure their own performance and decision making against that of a theoretical (or sometimes very real) private equity purchaser.

- **Global business environment:** Increased globalisation, the accelerated pace of change and competition, the impact of technologies and the ever-increasing focus on costs (both across the supply chain and through operational productivity) are all increasing risks and opportunities, heightening the importance of the board's oversight function. It is also placing a greater emphasis on board composition, given the value that can be added by board members with strategically critical skills and experience.

- **Chief Executive Officers (CEOs):** It is no secret that boards have become more demanding of CEOs in recent years, as the declining average tenure of CEOs clearly shows. At the same time, however, CEOs are becoming more demanding of their board members— particularly of their non-executive directors (NEDs), who are looked to for their independent judgment and perspective on both short-term and long-term strategic issues. CEOs are demanding that boards fulfil their governance duties efficiently, while supporting the building of the senior executive team and guiding succession planning. Indeed, we find that CEOs are often setting higher standards in this regard than their non-executive chairmen, and some are frustrated by the perceived quality of their NEDs.

Diagnostic Questions

There is no set definition of what constitutes a high- performing board; indeed, there may be too many variables for a comprehensive description. At the same time, however, there is a set of diagnostic questions that CEOs, chairmen and corporate secretaries can ask to help frame the issues:

- What do the various stakeholders (investors, regulators, the management team, banks, communities where the company has operations, etc.) expect from the company as an institution and from the board in its oversight role?

- What does the CEO need and expect from the board in terms of functional expertise, senior team building and succession planning, strategic guidance, etc.?

- How do the chairman and CEO define quality participation and contribution? Are those expectations clearly communicated through an effective induction process and measured through a regular individual and collective board evaluation process?

- Are the board's policies and practices as rigorous and effective as they should be? Beyond the mere meeting of regulatory requirements, does the board use its experience and expertise to help drive company performance?

- How does the Nominations Committee assess the competencies and skills needed for the board given the company's particular opportunities and challenges, and how does it identify potential board members in a way that goes beyond the "usual suspects"?

- Are there well-defined boundaries between the board and the executive team so that oversight does not encroach upon operations?

- Does the board have the strength and depth to steer the company through a financial crisis, a reputation- damaging event or sudden CEO resignation?

Elements of High Performance

While each company will answer these questions differently, our experience in working with boards suggests that high-performing boards focus on a common set of tasks, which include the following:

- Responding to executive strategy and contributing to rigorous debate. (The board brings fresh perspec- tives; it does not originate strategy.)

- Monitoring the implementation of the strategy through the operational plans.

- Overseeing the quality of leadership and manage- ment, ensuring that individuals are developed and that effective succession plans are in place.

- Maintaining a governance framework that adds value to the business.

- Safeguarding the company's values and reputation.

Characteristics of the High-Performing Board

What do boards need to be able to successfully accomplish these tasks and meet the expectations of their various stakeholders? We find that the best boards have four common characteristics:

- **Clarity regarding role and focus:** High-performing boards begin with a clear understanding of their role, scope of responsibilities and expected contri- bution to the long-term success of the company. Some boards have a formal charter that covers these points and which can serve as a touchstone to ensure continuity and common understanding.

- **An effective chairman:** The chairman sets the board's tone and direction as well as its perform- ance culture. He or she creates the appropriate environment for full engagement by all members of the board, drawing out opinions and shaping discussions of sensitive issues. Beyond the board and committee meetings, the most effective chair- men spend time with their NEDs individually—as frequently as once a quarter—to ensure that issues are discussed, performance is assessed, and timely and effective contributions are encouraged. The chairman manages the process of integrating NEDs and executives into a cohesive team in which all parties are aware of their responsibilities and bound- aries. Finally, effective chairmen have established an open and honest relationship with their CEO based on mutual trust and understanding.

- **A balanced board team:** A board is only as good as its members—particularly the NEDs, who bring the outside perspective and judgment on which the board's oversight function is predicated. And like many things in business, recruiting the right NEDs is something that is easy to talk about but hard to execute. A high-performing board includes NEDs who can provide broad strategic perspective while also bring- ing their specific experience and expertise to bear on boardroom issues ranging from the environment and climate change to globalisation. And high- performing boards are balanced not just with respect to expertise but to temperament as well, mixing analytical thinkers with visionaries, conciliators with challengers.

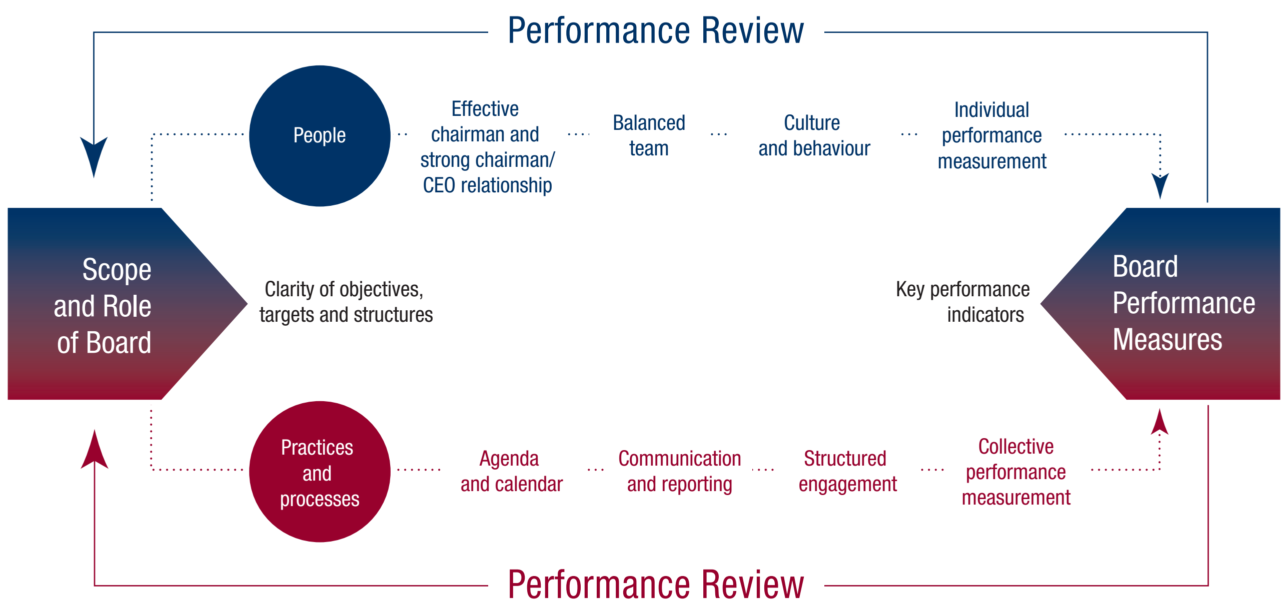
  Once the team is built, the chairmen of high- performing boards spend considerable effort integrating their NEDs and executive members: holding committee meetings the day before the board meeting, blending social interaction with substantive discussion at board dinners and, as ever, encouraging participation. Indeed, the conver- sation between the CEO and the board should be fluid and ongoing. The CEO needs to be comfort- able with using the group as a sounding board for ideas in their formative stage, so that he or she can get the full benefit of the board's expertise.

- **A culture of trust and respect:** A board is not a collection of individuals and talents but a team. For it to function as such, effective chemistry, candid communication and mutual respect are critical. This ensures that probing questioning, constructive criti- cism and challenging debate can take place between the NEDs and the executive team. It is through what one chairman calls "the bit of thrust", that the company truly reaps the benefits of an engaged board.

Quality Control Through Practices and Processes

In the past, many companies relied on the chairman's force of personality to determine and enforce the board's standards and practices. The increasing scrutiny of board performance, however, is placing an emphasis on the establishment of certain key processes that provide a framework for consistency and excellence. These processes include the following:

- **An agenda:** A transparent rolling board agenda that includes financial, strategic, governance, operational and human capital issues provides the structural framework for the board's oversight. Agendas should be flexible enough to recognise that issues evolve in real time rather than neatly fitting the board's calendar and should allow for board members to bring forth unscheduled topics. A good chairman is also continually assessing the board's prepared- ness for the unexpected, introducing discussion of hypothetical scenarios (a hostile takeover, a financial markets crisis and so on) at appropriate points. The board agenda should both inform and be aligned with the Executive Committee agenda and should be accompanied by the appropriate documentation and data to allow for informed discussion.



- **An annual calendar:** This document ensures that certain big-picture items, including long-term planning, strategy, operational plans and performance, succession planning, crisis management and human capital, are discussed by the board on a regular basis.

- **Communications and reporting:** The responsibilities of board committees and their reporting processes must be clear and supported by effective communications among the board, the company secretary and the Executive Committee.

- **Structured engagement:** In order for non-executive directors to make informed contributions, they need to get out of the boardroom and into the business, spending time with executives below the board level. Forward-thinking chairmen have NEDs accompany senior and middle management to meetings and conferences and link together NED management pairs on regular tours out in the field. Asking NEDs to give a short report at each board meeting regarding their engagement activities and learning adds an effective element of accountability and peer pressure to the process.

- Performance measurement and management: Measuring individual and collective performance is critical. Individual measurement begins with a formal induction and is sustained through regular appraisal processes. The performance of individuals and the board as a team should be validated by benchmarking and verified by independent external specialists.

Conclusion

There is no one recipe for having a high-performing board. Our observations suggest, however, that it requires a combination of "hard" components (including robust structures, clear roles and responsibilities, and rigorous processes and administration) and "soft" components (including directors with the right competencies to address the company's short-term and long-term issues and a strong chairman who has a healthy relationship with the CEO and who can establish a culture of vigorous discussion and effective decision making for the entire board).

Both areas require continuous focus and commitment to improve, particularly from the chairman, to ensure that the board's performance bar is raised. In reality, however, too few boards address both components with the necessary sustained rigour. Many either fail to identify and address areas for improvement or fail to commit the energy and resources necessary for real growth. We suspect that some chairmen may still be caught in a comfort zone, insulating themselves from either internal or external pressure to change.

In the current competitive environment, however, those pressures will continue to build—more and more boards are responding by taking a close look at their performance in order to avoid undermining investor confidence, inviting regulatory scrutiny or depriving management of the benefits of quality oversight.

Companies are finding that a formal third-party board assessment and performance benchmarking exercise can provide a helpful first step in moving chairmen and boards outside of their comfort zones and in identifying opportunities for strengthening corporate governance and overall board performance.

We will continue to investigate these corporate governance and board performance issues and share our findings. In so doing, we aim to prompt discussion and, more importantly, action through the adoption of best practices tailored to the unique circumstances of individual companies and their boards.

Author

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Leadership for a Changing World. In today's global business environment, success is driven by the talent, vision and leadership capabilities of senior executives. Russell Reynolds Associates is a leading global executive search and assessment firm with more than 300 consultants based in 40 offices worldwide. Our consultants work closely with public and private organizations to assess and recruit senior executives and board members to drive long-term growth and success. Our in-depth knowledge of major industries and of our clients' specific business challenges, combined with our understanding of who and what make an effective leader, ensures that our clients secure the best leadership teams for the ongoing success of their businesses. **www.russellreynolds.com**

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