CHAPTER 1

The Four Pillars of Board Effectiveness

Over the past decade, we have witnessed dramatic and unprecedented developments in business, politics, and society. The main upshot of this has been the growing realisation that governance is the determining factor behind the success and failure of organisations. And with fresh evidence of abdication of duty in the corporate and policy-making spheres emerging on a weekly basis, there are growing demands for better governance in different countries, and for all types of organisations – businesses, governments, NGOs, and many others.

When we refer to governance, we mean the quality of decision-making and implementation at the top of organisations – and the processes to ensure these. Increasingly, boards are seen as having a key responsibility and role as the 'owner' of governance in an organisation. It is their competence, structures, and integrity, and their interactions with CEOs and management teams, that shape the governance DNA of organisations.

Until a few years ago, governance and boards were considered to be well understood, and operating along standard and predictable lines. As a result, the subject attracted relatively little attention from researchers. But the situation changed significantly as more stories of corporate malfeasance appeared in mainstream media, industry publications, and academic journals, inevitably accompanied by the question 'Where was the board?'

Indeed, events during the past decade have made it clear that boards can fail in various ways. They have failed to manage risks, failed to contribute proactively to firm strategy, failed to identify the 'right' team, and, in some cases, failed to deal with integrity issues and possibly outright fraud. We will discuss board failures and challenges in more detail in Part II.

Partly as a consequence of these much-publicised and damaging failures, today's boards are eager to improve their performance and to continually fine-tune their effectiveness. They have become more cognisant than ever of their role in supporting their organisations' long-term success by aiming for world-class governance.

So, if business as usual is not an option for boards, what are the main dimensions to target when trying to make a board function better? How do we distil the key factors that contribute to board effectiveness?

In our work over the years inspiring the boards of organisations around the world toward greater success, my team and I have identified four discrete pillars of board effectiveness (see Figure 1.1).

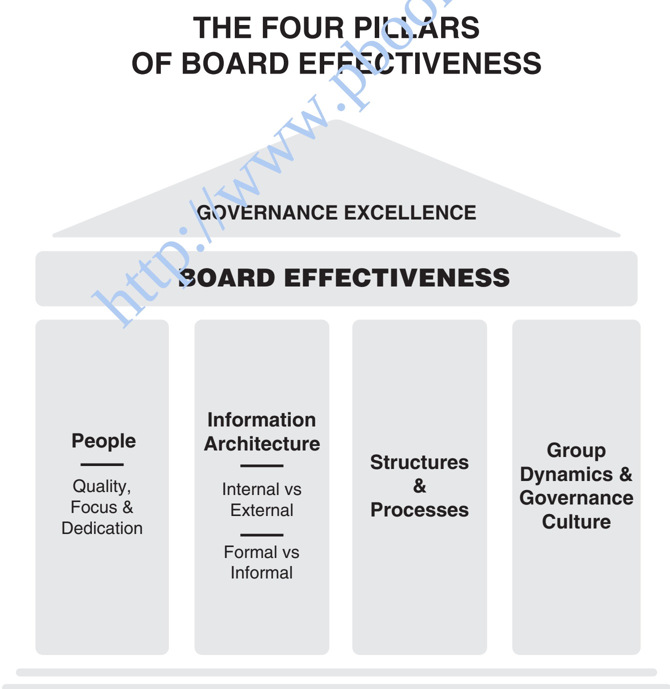

Figure 1.1 Governance Excellence Rests on Four Pillars

These are people quality, focus, and dedication; information architecture; structures and processes; and group dynamics and board culture. We will explore each of these pillars in detail in Chapters 4 to 7.

This simple framework for assessing a board's effectiveness has a deep-rooted underlying rationale, and its practical application has helped to transform boards for the better in many different contexts. These include large publicly traded companies, family owned businesses, non-profit organisations, governments, and other bodies, across all geographies, and in both developed and developing contexts.

The four-pillar methodology, focusing on systematic and continuous improvement along each dimension, has proven to be a strong asset for all types of organisation.

The First Pillar: People Quality, Focus, and Dedication

A boardroom is a social place, as is business in general. Therefore, the first of the pillars that support a board's effectiveness consists of the people who socialise, interact, learn, make sense of situations, and reach decisions in the boardroom. Their quality, focus, and dedication are often what makes or breaks a board's ability to perform effectively.

The quality of the board's composition and functioning is crucial. For starters, members of the board and its committees are expected to have the necessary and relevant knowledge. Boards are typically composed of experienced, accomplished individuals from a variety of backgrounds, including top managers, public officials, and education experts. Yet these backgrounds do not automatically give them the knowledge they need to contribute effectively to the work of a specific board.

As we have seen time and again in recent years, having limited knowledge hinders a board member's effectiveness. Whenever a major corporate initiative has run aground, the board members' technical and other specialised knowledge has come under scrutiny. Effective boards therefore ensure that performance and knowledge standards are articulated and tailor-made for individual directors, with the help of matching learning modules and other opportunities. Board members' performance can then be evaluated against those standards.

The quality of the board is further enhanced by its diversity of gender, personality, and opinion. (For a fuller discussion of diversity, see Chapter 23.) In particular, high-quality boards are typically successful at managing their mix of personalities. How many times have we read news stories attributing boardroom confrontations, showdowns, and dramatic exits to a 'clash of personalities', 'incompatible personalities', or, to use a euphemism, 'strong personalities'? The example of Steve Jobs being fired by the board of Apple is just one of many such cases.

To avoid becoming one of these headlines, a board needs to map out, understand, and learn to work with the range of personalities on it. As in all such exercises, this requires tools or 'cognitive handles' that help to capture not only the composition of personalities and the risks involved, but also the configurations which, with a bit of planning and effort, can help to infuse the board with additional vibrancy and strength of performance.

Boards can productively employ and draw on a number of taxonomies in this regard. For instance, personality diagrams highlight board members' introversion or extroversion, their abstract 'big picture' thinking or orientation to detail, their level of emotional reactivity, and the emphasis they put on competition as opposed to harmony. The well-known NEO Personality Inventory framework describes the 'Big Five' dimensions of personality: emotionality, introversion/extroversion, openness to experience, agreeableness, and conscientiousness (see Chapter 13 on Group Dynamics and Board Culture).

As important as skills and quality are, directors must also be focused and dedicated. Yet these attributes are often missing, in varying degrees, from the boardroom.

Dealing with ambiguities in decision-making is inevitable – in fact, it is a sign that the board is addressing real issues. But when directors misunderstand their roles and functions, their focus suffers. To sharpen and re-energise it, boards would do well to establish their own statement of purpose (often codified as a board charter statement) and define their role in a way that adds value to the company's activities. Boards need to reflect regularly on their involvement and strive to make it firstly distinctive, so that they do not replicate the efforts of other parts of the organisation; and secondly additive, whereby the board builds upon decisions made by the firm.

Well-focused boards know how to distinguish between contexts. From there, they determine whether they should perform a supervisory role or rather offer support to management. Such boards are ready to be proactive and jump into pre-emptive action when they see signs of risk and recognise that oversight is needed. In other situations, such as during a crisis when the organisation's reputation is at stake, they are just as efficient in identifying and acting on the need to communicate the firm's strategic objectives. In addition, a board's focus can be strengthened by having the right agenda: one that looks more towards the future than the past, and that aims to capture long-term issues while managing short-term matters.

But even high-quality, focused boards will underperform if their members are not fully dedicated to their work and to the organisation. Directors frequently tell me that their board meeting discussions reflect a level of preparation that was 'basic' and 'not in great depth'. A minority of them do report rich and diverse preparation, where board members have diligently read the relevant documentation and obtained external information where necessary. But all too many describe the board members in their organisations as typically 'not very well prepared'. The percentage of directors who have regularly witnessed great preparation for board meetings, with members actively consulting outside sources and analysing information in depth, is in fact small.

A similar picture emerges when we ask board members how many hours of preparation time one hour of a board meeting requires from each director. Typically, more than half of them estimate one to three hours of preparation, around 25% report three to seven hours, and only a minority report seven to ten hours. It is rare to hear of directors spending more than ten hours preparing for each hour of a board meeting. Worryingly, in fact, a few say that less than one hour of preparation time is required – even though most responsible individuals believe that a director should not sit on more than five boards at once anyway. Is this what board work has come to?

A director's sense of dedication should entail precisely what the word implies: giving freely of one's self, and not just because of the high-powered networking, access to industry information, and higher social status and income that come with the position. And, indeed, there are many directors whose main motivation for joining a board is their desire to contribute to the company's success, and who consider it an honour to serve in this capacity. These are the types of dedicated individuals that boards need to attract and empower: people of integrity, character, and conviction who are ready to speak up and voice their concerns for the greater good of the organisation.

The Second Pillar: Information Architecture

Sophisticated information architecture is key to successful boards. Although this design does not necessarily need to be complex, it should inform the board about all the company's essential activities and the issues facing it, both now and in the future. When considering information design, directors should have three rules of thumb.

First, board members should have as much information on external issues as they do on internal matters. Boards typically think of information as coming from management. Ideally, this will be brief, well focused, prioritised, and strategic, with executive summaries, key issues to tackle, and options to consider. But directors should also be fully informed regarding external issues, such as reputation analysis, the competitive landscape, customer knowledge, an understanding of shareholders, and technological evolution. Often, however, this is not the case, resulting in boards that do little more than go through the motions. Clearly, there is significant room for improvement.

Second, directors should have both formal and informal information channels. Formal internal information should be jointly designed by the board and management, with briefings that include financials with forecasts, a CEO report, risk and opportunity maps, analysis of the management gene pool, and a summary of financial analysts' views. In addition, regular communication between management and the board, for example via management letters between meetings, provides further efficient and timely information. Board committee reports are also fundamental in building the depth of knowledge required by directors in specific areas – as long as such reports include analysis of the issues and not just recommendations. It is critical that the board is actively involved in designing the information, including whether that design should change along with the firm, its environment, and its strategy.

At the same time, informal channels of information are key, and need to be cultivated. These channels should be diverse and well structured, giving board members access to employees and stakeholder networks, links to fellow directors outside board meetings, and connections with management. This might be through a Sunday afternoon barbecue, a coffee during the week, or an early evening call, depending on the board member. Such interactions must strike the right balance, providing board members with greater freedom and inspiration without infringing on management's role.

Third, dedicated directors should aim to receive as much information from independent sources as they do from management. Rather than relying solely on management information, these board members see it as their duty to track down the most useful social media posts, market information, and other sources.

The Third Pillar: Structures and Processes

As governance becomes more sophisticated, its structures have likewise evolved greatly. Board effectiveness is hugely influenced by the quality of the structures and processes organised by the board secretariat and steered by the chair. It is imperative that boards regularly benchmark these against the ideal situation and act to address any divergence.

In the most basic structural terms, the size of the board should be carefully examined, in addition to the necessary number and effective functioning of board committees. The main goal is to ensure that the board's committee structure is pertinent to the current reality of the organisation. There are a number of innovative and inspiring examples in this regard, such as HSBC's committee on Financial System Vulnerabilities, which addresses one of the primary strategic issues in banking today. In addition, board innovation committees are becoming increasingly common at companies operating in industries at high risk of disruption. Both Procter & Gamble – a global giant in fast-moving consumer goods – and UK-based bank RBS have a Technology and Innovation Committee on their respective boards, for example.

As we mentioned earlier, beyond its structural 'hardware', a board should radiate a well-managed diversity of personality, experience, gender, and opinion. The independence of board members is crucial too – but so is their structured access to the right individuals. For example, in some organisations the chief risk officer has a dotted reporting line to the chair of the risk committee, or to the chair of the board.

Along with structures, a number of processes need to be in place to ensure that the board systematically addresses the issues within its remit. The list of processes that truly matter includes agenda setting, reviewing and monitoring management performance, CEO succession, stakeholder engagement, audit, regulatory compliance, risk, strategy, ongoing board improvement, and many others.

A strong board will integrate these processes smoothly within its yearly agenda. Below, we briefly discuss four of them: strategy, agenda setting, evaluation, and CEO succession. We then examine board structures and processes more closely in Chapter 6 and other parts of the book.

The board's strategy process is critical to increasing its effectiveness. Strategic board involvement occurs along three dimensions – co-creation, supervision, and support – and good processes will enrich all three. Typically, regular board meetings will complement retreats, and external presentations will add to internal ones. Focused, decision-oriented meetings will complement boards' long-term strategic understanding of the company and its industry. A well-designed board strategy process strengthens the firm's strategy by helping to define it, aligning it with objectives and ensuring commitment. Ultimately, this enables boards to efficiently assess the company's strategic risks and opportunities. We will discuss the board's strategic role in more detail in Chapter 15.

Setting the agenda is another key board process. This necessarily involves a number of balancing acts, such as board-management interaction, consideration of stakeholder issues, clear prioritisation, a focus on key issues, and time management. A strong agenda-setting process will be both strategic, by providing a high-level setting for the next two years, and tactical, by ensuring the board spends its time on the most critical issues.

A third decisive process is board evaluation. When directors are not performing to the standards set by the board, they need to receive feedback clearly indicating this. A poor evaluation process contributes to governance failure, which is why thriving boards engage in a formal assessment procedure. This might be self-assessment or external assessment, and should cover individual directors' roles, dynamics, and performance. A good practice is to utilise technology. Using smartphones or tablets to evaluate board sessions during meetings, for example, provides results in real time and offers an opportunity for careful and dynamic scrutiny in between annual evaluations.

Finally, CEO succession is a critical process that requires ongoing attention and planning. Whether based on an internal or external 'horse race' or search, the process of identifying leadership talent and candidates should focus on the transparency of selection criteria, the fit with the organisation, the quality of the on-boarding process, and the smoothness of the transition.

Hewlett-Packard (HP) provides a good example of difficult successions creating real governance risk. In a period of six years, HP fired three CEOs, resulting in corporate turmoil that negatively affected the company's brand reputation. In one of the cases, the HP board did not meet the new CEO before proceeding with the nomination. This raises questions regarding the process in place, and the implied failure of the board to identify a candidate who would fulfil the company's strategic vision.

The Fourth Pillar: Group Dynamics and Board Culture

The three board effectiveness pillars we have examined so far include focused, dedicated people accessing different types of information and applying this to increasingly sophisticated structures and processes. In keeping with this strongly social, people-centric snapshot, the dynamics within this group of people constitute the final pillar in our edifice. This pillar concerns how board members interact as a group, and what they individually bring to and collectively take away from their discussions. Over time, these dynamics give rise to a specific board culture: a set of customs, practices, and often unspoken rules about 'how we get things done around here'.

As with any group, it sometimes doesn't take much for a board to go down the path of inefficiency and dysfunction. Sleepy, low-energy boards are sadly quite common. And in some cases, dysfunctional dynamics are intentionally used to set a board up for governance failure – for example, through late distribution of meeting documents and not making relevant information available. But some of the more benign board pathologies can be just as destructive. These include the presence of disruptive or dominating members on the board, or a tendency to group-think, where board members avoid any paths less travelled in an effort to ingratiate themselves with the group.

These dysfunctions are often symptoms of a deeper issue, such as a lack of trust or overlapping roles. Governance is enriched by directors' different opinions and constructive dissent; having a critical view of assumptions makes for an effective strategy. Yet some firms appoint directors who are close associates of the company's founder or CEO. They may be prominent figures in their respective industries, but their role on the board is circumscribed by their relationship with a dominant figure in the company.

Interactions between the board and senior management are an important aspect of this pillar. BlackBerry (formerly Research in Motion) once thrived on the long-running partnership and friendship of its two co-CEOs. Once they stepped aside, deep divisions surfaced within the company and the board regarding its flagship product, key technology alliance, and planned China expansion, with the new CEO actively canvassing behind the scenes to kill off some of these flagship initiatives. BlackBerry's share price then plummeted, and its product offerings were considered late to market.

Although conflict is important for an open exchange of views, boards are more effective when discussions remain productive. This can only be achieved if a board makes its rules of engagement clear to all its members and promotes their equal participation and mutual respect. Functional board dynamics can help to avoid conflicts of interest, especially if the board culture emphasises accountability towards relevant stakeholders and is based on openness and constructive dissent (see also Chapter 13). And a culture that ensures board members are connected to reality also reduces the likelihood of them being overconfident.

The chair's role is key in developing a successful board culture. This can be partly formalised in writing in order to be easily shared and understood. An awareness of discussion styles (such as fast thinking, influencing, and the 'false yes') and decision styles (whether autocratic, consensual, or indecisive) is similarly essential in managing group dynamics. We will look at these in more detail in Chapter 7.

Even more fundamentally, boards are now increasingly discussing their common values, and the level of stewardship they want to provide to the organisation. Do board members share the same long-term perspectives? Do they have a common view of their contributions to society, and of their impact on employees, customers, and other stakeholders? This will form the focus of Chapters 27 and 28.

Board effectiveness requires constantly sustaining the four pillars we discussed in this chapter. A board cannot neglect the quality, focus, and dedication of its members. Information architecture needs to be carefully designed in order to optimise its effectiveness. Successful boards continuously improve their structures and work processes as they become more sophisticated. Finally, effective board dynamics, based on a culture that promotes quality discussion, greatly contribute to the strategic coherence of the firm.

Excellence in these areas makes for sustainable success in board practices. Although the four pillars do not constitute a foolproof guarantee against board or company failures, they provide a solid foundation for good governance and help to make organisations more resilient. And as we will see in Chapter 2, good governance is becoming increasingly vital around the world.