Article originally appeared in

POINT *of* VIEW

A SPECIAL ISSUE FOCUSING ON TODAY'S BOARD & CEO AGENDA

5 things board directors should be thinking about

CARLO CORSI, *Milan and Rome*
GUILHERME DALE, *Sao Paulo*
JULIE HEMBROCK DAUM, *New York*
JOHN W. MUMM, *Sydney*
WILLI SCHOPPEN, *Frankfurt*

The role of the outside or nonexecutive director has been attracting increasing scrutiny in recent years, and there has been no shortage of advice from shareholders, politicians and the media on what board directors of listed companies should be doing with their time. Unfortunately, much of this advice is unhelpful, often betraying a lack of understanding about what is reasonable to expect of directors or how they can put their experience and expertise to greatest effect.

Our view is that most board directors have adapted well to this new era of accountability and are doing a competent job in a difficult environment. They successfully balance their ever-expanding fiduciary duties with their role as advisers, supporting and challenging their senior executive teams. What does it mean for a board to perform well? It depends on what standards the board sets for itself. These days, the majority of boards comply with the law, observe listings requirements and uphold nationally accepted governance principles. They comprise successful, experienced directors who undertake their responsibilities diligently and are proud of the companies they serve. Yet despite this, we suspect that most boards are not fulfilling their potential.

Having worked with boards around the world at close quarters, we have identified a number of characteristics that distinguish exceptional boards from the rest. In this article, we focus on five areas of board activity. Some of these are traditional responsibilities where boards should always be striving to improve their performance; others are emerging as more important concerns than they have been in the past.

1. Effective board leadership

The effective functioning of a board depends on a number of factors, including the mix of knowledge and experience among the directors, the quality of information they receive and their ability to operate as a team. The chairman's role (or that of the lead director on many U.S. boards) is pivotal in managing the group dynamic, playing to the board's strengths and maintaining regular contact with directors between meetings. High-functioning boards rotate meetings around company locations, simultaneously educating directors about different aspects of the business and giving them access to key executives. Directors are invited to attend all committee meetings and are free to ask questions, however difficult. Boards not only evaluate the performance of the CEO, but take the formal assessment of their own work seriously and use the findings to develop — and hold themselves to — objectives for improvement. Transparency and trust prevail.

As businesses reinvent themselves, so should boards. Effective boards ensure that they have the right people at the right time. This is largely the responsibility of the chairman and the nomination or governance committee. Together they play a vital role in defining the board's needs, seeking the appropriate diversity of perspectives, and overseeing a rigorous recruitment process. As an individual director, however, you have a responsibility to ask yourself periodically whether you are still the right person for the board. It takes considerable self-awareness to assess the value of your contribution, to consider your "period of validity" and to be prepared to step down if necessary when the business has moved on.

Boards can get more out of their directors by adopting processes that promote efficiency and good communication, both among directors and with external parties. Ensuring that board papers are timely and thorough and that information is easily accessible to directors between meetings is essential. One criticism leveled at board papers is that they are top-heavy with facts and figures, too backward-looking, and not sufficiently focused on strategic issues. Another way of helping directors give their best to the board is through well-planned induction programs and by offering continual opportunities for directors to increase their understanding of the business and keep abreast of changes to legislation or governance codes. Finally, effective boards place a premium on good communication, whether it be with fellow board directors, key executives or shareholders. This needs to be orchestrated by the CEO and/or chairman, but directors need to insist on the highest possible standards of communication — whether it be presenting compensation decisions to shareholders or feedback from the latest board assessment.

2. Strategy

Progressive boards put their companies at a distinct advantage; nowhere is this more evident than in the way they address strategy, from formation through to execution. The conventional delineation of responsibility is that the executive team develops strategy, the board fine tunes it and then oversees its execution by management, measuring the CEO's performance against a set of agreed-upon objectives. The most common catalyst for this process is an annual strategy day where the CEO, supported by his or her management team, reviews a set of strategic options, assesses competitors' strategy, and makes recommendations. Given that the company's success and shareholder satisfaction are dependent on the board making wise strategic decisions, it is vital that every director be fully engaged. However, for this to be the case they must be absolutely clear about what is expected of them in the strategy discussion and how much leeway exists to question, challenge or throw out proposals.

Key questions directors should be asking

Board Effectiveness

- Does my board have the right governance model?
- How is my board adding value to the company?
- Is the board striking the right balance in its attention to governance and regulatory issues and performance?
- Is the prevailing board atmosphere collegial or tense?
- Is the board getting the most out of its annual assessment?
- What should the board look like in the future to address the changing external environment and evolving strategic priorities?
- Are my skills and experience still the right ones for the board?
- What is the right balance between broad-based business experience and specialist expertise?
- Do we have sufficient information to make wise, informed decisions?
- How do I ensure that I am staying current? Does the board provide the continual education I need?
- Am I happy with the quality of board-level communication, both internally and externally?

Strategy

- What is the board's role in developing and critiquing strategy?
- How much leeway exists to question, challenge or throw out proposals?
- What is the best way to delineate responsibility for developing, discussing, fine tuning and executing strategy?
- What is the right balance between advice and control?
- What is most valuable: knowledge or perspective?

Risk Oversight

- How should the board structure its assessment and supervision of risk?
- What are the roles of the board and management in managing risk?
- Is the board clear about its appetite for risk?
- To what extent do personal considerations affect my attitude to risk?
- Do I know what the organization's risks are? Do we spend time on "what if?" thinking?
- Is the heightened awareness of risk stifling innovation and creativity within the executive team?
- How does the board view reputational risk?

Succession Planning

- Am I confident that the most rigorous succession planning methodology is in place:
  - for the CEO and executive committee?
  - for the chairman?
  - for the rest of the board?
- Do we have contingencies for both planned and emergency succession?
- Do we have a clear line of sight into the executive ranks below the executive committee?
- Am I confident in the tools available to assess potential successors?

Sustainablity

- Are decisions being made in the long-term interests of the enterprise?
- Is the board committed to, and debating, corporate responsibility issues?
- Are corporate social responsibility, sustainability and climate change issues factored into company strategy?
- Are they seen as generating costs rather than benefits?
- Should sustainability be the responsibility of a dedicated board committee?

Great boards consist of independent directors who are "rowing together in the boat." They see the development of strategy as a collective effort between themselves and management, rather than a question of "us versus them." Management generates and shares ideas that stimulate debate among directors who are there to make positive, valuable contributions to strategy development, not just to provide a critique of the ideas they are presented with.

3. Risk vs. initiative

Since the start of the most recent economic crisis, boards have been urgently rethinking their approach to risk oversight. Outside financial services, where risk committees are well established, responsibility for risk still tends to lie with the audit committee, where the majority of time is spent on financial risk. These days, risk needs to be defined in the broadest terms, encompassing not just financial matters, but also areas such as health and safety, the environment, IT security, industrial relations and corporate reputation. Boards should determine whether they have the optimal structure for overseeing risk, including whether there is a clear delineation of risk management responsibilities between the board and the executive. Great boards institutionalize risk, they don't necessarily police it. They tailor their participation and committee structure to the sensitivity of their business to risk.

The board should review its risk appetite on a regular basis. It is worth directors stepping back to assess the extent to which personal considerations may affect their attitude to risk, since this will have an impact on the degree of latitude available to management to pursue their business objectives. Boards need to be aware that heightened sensitivity to risk may stifle innovation and creativity. These days, risk downside tends to get far more attention than risk upside; many take the view that entrepreneurialism inside large corporations is under threat due to increased risk aversion. A strong and fearless board will acknowledge that risks are inherent in any business that is going to deliver long-term value to its shareholders and, with the right executive team in place, its members will have the confidence and trust to back the CEO when new opportunities arise.

4. Succession

When asked about succession planning, most directors acknowledge its importance but admit that more could be done by their board to establish a rigorous process to identify the next CEO. This is borne out by periodic high-profile emergency succession events that reveal a remarkable lack of preparedness by boards, usually spooking the market and diminishing the share price. On those occasions when companies manage a seamless CEO transition, whether it is planned or an emergency, the reaction is invariably one of surprise that preparations should have been handled so discreetly and effectively.

A great board will make succession planning a regular agenda item. It will start the process as early as possible — even if this makes the incumbent uncomfortable — and will also consider succession for the chairman (where the roles are separated) and the rest of the board. When the lead CEO candidates are internal, boards will also conduct external benchmarking. In Germany, the supervisory board must by law involve itself in succession planning for the entire senior management team. Elsewhere, the best boards take the initiative on succession, usually led by a committee, and ensure they have regular contact with senior executives in all divisions and geographies, requiring the CEO to plan for the succession of his or her senior leadership team. A conscientious director will want to be satisfied that the board has a rigorous succession planning methodology in place providing for both planned and emergency scenarios, and that the board is confident in the tools available to assess potential successors.

5. Sustainability

Boards of listed companies have an obligation to build and protect long-term shareholder value and to ensure that short-term decisions do not jeopardize the sustainability of the enterprise. In South Africa, the notion of sustainability is woven into the constitution and affects every listed company; it is considered inseparable from strategy and good governance. All forms of capital — financial, human, natural and social — are seen as essential for value creation. Other societies and governance codes are far less explicit about the link between sustainable practices and shareholder value, but evidence is mounting that boards overlook corporate social responsibility at their peril. While this issue will manifest itself in different ways depending on the industry sector, it is worth directors reviewing their board's attitude to corporate social responsibility and wider stakeholder issues and consider whether they require more attention — ignoring both can carry a strong element of risk. The habit that great boards have adopted is to view sustainability in its various forms as coterminous with long-term shareholder value.

ABOUT THE AUTHORS

Carlo Corsi is a member of the Financial Officer, Board Services, Industrial and Consumer Goods & Services practices and leads the firm's business in Italy. Guilherme Dale leads the firm's Board Services Practice in Brazil and is also a core member of the Industrial Practice. Julie Hembrock Daum co-leads the North American Board & CEO Succession Practice and is a member of the Spencer Stuart board. John W. Mumm leads the Board Services and CEO practices and the firm's succession planning services in Australia and Asia Pacific. Dr. Willi Schoppen is a leader in the Board Services and Financial Officer practices in Germany.