

# Board Effectiveness Insights

Chapter 1 / Version 2.0

January 2004

## FOCUS

BOARD EFFECTIVENESS PARTNERS (BEP) collaborates with directors and CEOs to objectively analyze and improve the effectiveness of their boards.

## INSIGHTS

We publish *Board Effectiveness Insights* periodically to encourage dialogue on strengthening board effectiveness. We welcome your suggestions, thoughts, and agreement or disagreement. Please visit [www.bepartners.com](http://www.bepartners.com) for more details and other chapters of *Board Effectiveness Insights*.

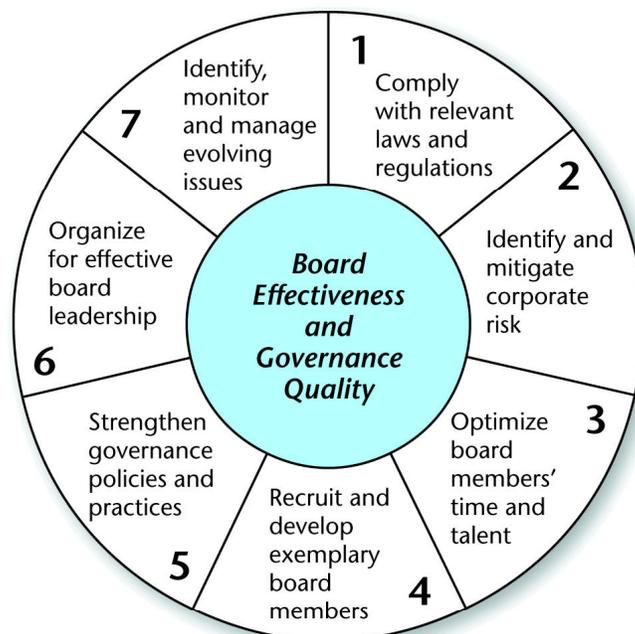
## A ROADMAP: STRENGTHENING CORPORATE GOVERNANCE

In 2001, business headlines were dominated by several prominent companies that were severely damaged or destroyed as a result of scandalous leadership. In 2002, reaction to scandals produced a new regulatory environment affecting all American corporations, and Sarbanes-Oxley entered the vocabulary of corporate leaders, professional advisors, and investors. Compliance with Sarbanes-Oxley joined regulations issued by exchanges and the SEC as a component within the governance equation, mandating a series of new standards for directors and officers.

However, compliance with the new rules does not address the costly and career-threatening “bloodbaths” left by the leadership scandals: irreparably damaged reputations, litigation, staggering investor losses, and skyrocketing director and officer insurance premiums. Nor—equally important—does it ensure governance quality and board effectiveness.

Compliance may reduce the likelihood of a recurrence of the business headlines of the past, but it will not materially improve bottom lines in the future. Compliance does nothing to drive continuously improving corporate performance.

Based on our experience, extensive ongoing research, and collaboration with colleagues, Board Effectiveness Partners (BEP) believes there are **seven essentials** to be considered as boards improve their effectiveness and governance quality.



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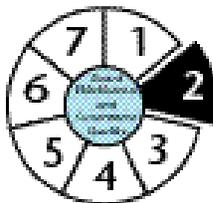
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## Focus on Performance

After years of study and experience, BEP's Managing Partners last year undertook both primary and secondary research—reviewing more than 200 governance articles and studies. They also interviewed more than 150 leaders in corporate governance—in a comprehensive, focused assessment of board effectiveness. BEP's *Roadmap*, built on that research and analysis, lays out governance best practices and strategies in the critical checkpoints that follow. The goal of BEP's *Roadmap* is to offer direction in enhancing contemporary governance quality and enabling corporate leaders to continually improve board effectiveness.

Just as corporations constantly evolve and seek creative and more effective ways of doing business, BEP's *Roadmap* will be a work-in-process for the foreseeable future. As new policies and practices, new situations, new markets, and new industries continue to take shape, BEP's *Roadmap* will be updated to capitalize on the lessons learned by business leaders who focus on board effectiveness and governance quality.



### 1. Comply with Relevant Laws and Regulations

**Compliance:** While BEP focuses on partnering with boards and CEOs to continually improve effectiveness, we recognize the importance of, and take as a given, full compliance with the law, including Sarbanes-Oxley, as well as exchange, SEC, and industry-specific regulations.

### 2. Identify and Mitigate Corporate Risk

**Corporate Risk Mitigation:** BEP believes that it is vital that boards periodically complete a comprehensive and independent assessment of corporate risks, mitigation plans, and implementation progress. From BEP's perspective, risk identification and mitigation has three phases:

- ▶ **Assessment.** Mitigating risk begins with a comprehensive, focused assessment that highlights “landmines” and strategies for risk mitigation.
- ▶ **Implementation.** Value to the enterprise increases with careful, thorough, and measured implementation of risk mitigation plans.
- ▶ **Monitoring.** Risk mitigation is an ongoing process, including consistent monitoring of risk mitigation goals, implementation progress, and evolving risks to the enterprise. Monitoring mitigation progress enhances long-term viability and stability.

### 3. Optimize Board Members' Time and Talent

**Culture:** Developing and fostering an effective board culture entails careful planning and ongoing effort on the part of board leaders and CEOs. An “accidental” culture is not likely to enable board effectiveness.

- ▶ Define and create a board culture that ensures collaboration, candid and open debate, and constructive dissent to fully explore options and facilitate well-informed, expeditious decision making.
- ▶ Ensure that each board member's expectations and each of their roles are clearly delineated and understood.

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To be a significant contributor to an effective board requires **TIME**, both time to prepare and time to devote to the task. This simple truth is an often overlooked component of board effectiveness.

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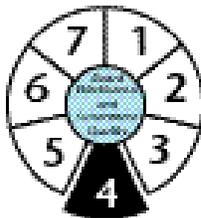
**Director Development:** Enhancing directors' insight and competence is an ongoing process that must be nurtured and monitored across the full spectrum of governance activities.

- ▶ Develop and maintain a director orientation and education program, ensuring that each director understands his or her role and the strategy and tactics essential for the company's success.
- ▶ Enhance strengths and mitigate weaknesses of board members through mentoring and coaching by those board members who are more effective.
- ▶ Facilitate the education of directors with respect to the company and its strategies, marketplace, and competitive horizon. Where appropriate, employ leading-edge tools, such as technology-enabled education.
- ▶ Establish clear accountabilities for each board member, beyond their "member-at-large" roles, in order to develop and nurture specialized resource pools within the overall board. For example, recognize and capitalize on unique board member business and market competencies in areas critical to the company's growth and success.
- ▶ Ensure that the board periodically invests several hours to review one or two particularly complex issues. These periodic reviews can be supplemented by board member visits to operating units and meetings with division management, employees, customers, partners, suppliers, regulators, and others essential to the company's success.
- ▶ Recognize the necessarily dynamic nature of the board and its members; as the company's environment evolves, so too should the board's organization and its leadership and director roles.

**Communications:** The effectiveness of board meetings is enabled—or disabled—by the communication in advance of each meeting.

- ▶ Establish a communications plan to improve the quality and timeliness of information received by board members. Information is vital for CEOs to protect shareholder interests and for board members to collaborate effectively with each other, the CEO, and the senior leadership team.
- ▶ Board members should be in a position to ask for information in a fashion which neither threatens nor is misinterpreted as "meddling."
- ▶ Board leaders and the CEO should collaborate in defining the board "information-briefing" package. Ensure directors have access to senior management and company information.
- ▶ Board members should spend time with investors to learn more about their perception of the company's business. For example, in family-owned companies, it is vital to understand the family owners' values, priorities, vision, and investment expectations.
- ▶ Board members should stay abreast of trends and be educated by the company and independent sources on key strategic issues.
- ▶ Board members should be encouraged to secure access to independent research

At least 50 percent of each board meeting should be focused on the future—organic growth, acquisitions, and talent development. Historical facts can be provided as background reading via a password-protected Web site or in hard copy. Valuable board time should not be used to present facts.



on their company.

**Board Mechanics and Meeting Dynamics:** With board member roles being expanded and regularly redefined, the characteristics of board meetings have become similarly dynamic.

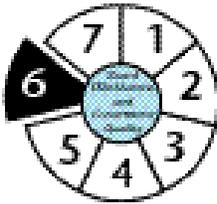
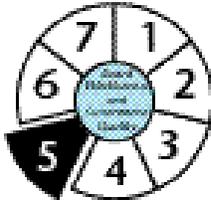
- ▶ On an as-needed basis, create and foster action teams of board members and outside experts. In addition to standing committees, create teams of directors to address strategic initiatives, including acquisitions, divestitures, CEO transitions, and crisis management.
- ▶ Conduct board meetings frequently—at least 6 times a year—and more frequently in times of transition or crisis. For larger companies, meeting 10 to 12 times annually is typical. Leverage current technology, such as “new generation” video-conferencing, to enhance collaboration with board members unable to attend meetings in person.
- ▶ Allow adequate time for board members to fully understand issues and to shape and guide strategy. Make certain that board meeting agenda items are spread far enough apart to allow ample time for the issues to be adequately addressed. Due to time pressures, the most important issues should be addressed first, not last.
- ▶ The agenda-setting process should be strategic, ensuring that the board is focused and performs effectively.
- ▶ Ensure that each board meeting includes time for unstructured discussion among board members and management.
- ▶ Set aside time during each board meeting for a directors-only session, allowing board members to have an agenda and a “free and open” conversation without management present.

#### 4. *Recruit and Develop Exemplary Board Members*

**Addressing Board Needs:** Recruiting new board members requires a holistic approach, asking simple yet essential questions— “What are the board’s skills? What skills does it need?”

- ▶ When recruiting, focus on the attributes and likely contributions of board members, not their “celebrity value.” Identify specific skill and knowledge gaps that new directors must fill.
- ▶ Board member prominence and diversity are valued, but they are secondary to competence, objectivity, commitment, and the capacity to serve investors and fellow board members.
- ▶ The number of boards on which a board member may serve should be carefully assessed and held to a minimum. Active CEOs’ board memberships should be even more limited.
- ▶ Depending on a company’s needs, some board members could be focused internally. On the other hand, the chairman or CEO might request that other directors have external roles that could include partnering with management to strengthen the company’s position with critical customers and suppliers, markets, institutional investors, regulatory agencies, or industry groups.

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## 5. Strengthen Governance Policies and Practices

- ▶ Conduct annual evaluations of the CEO, the chairman, the overall board, existing committees and teams, and each director. Take steps to enhance the performance of less effective directors, or replace them as board members.
- ▶ Design compensation packages that are market-based and competitive, with the majority of compensation in the form of deferred stock. Be sensitive to the ongoing “religious debates” about overpaid and underpaid board members. Recognize that compensation guidelines developed before 2003 may no longer apply. Be pragmatic, creative, and focused on shareholder interests as well as on “how this might read on the front page of the *Wall Street Journal* or *Financial Times*.”
- ▶ Limit boards to a manageable size, typically fewer than 15 members. BEP has identified sound research that argues that a 7- to 9-member board is ideal. Recognize that board size may increase temporarily under special circumstances, such as mergers.
- ▶ Maintain board-approved succession plans for the CEO, board chairman, board members, and the CEO’s direct reports. Reconsider the plans at least annually.
- ▶ Designate director roles and responsibilities in a manner consistent with laws, regulations, and sound business practices—and based on the individual board member’s competence, interests, objectivity, and independence.

## 6. Organize for Effective Board Leadership

**Be cautious** . . . whenever the board chairman and CEO positions are combined. Depending on the company’s stability and stage of maturity, the roles and accountabilities of the CEO and board chairman are frequently different in terms of scope, focus, and the competencies, time, and experience required for success.

- ▶ Clarify the CEO’s role: Continually refining strategy and managing strategic initiatives, operating the business, building and leading the senior team in delivering the performance metrics approved by the board.
- ▶ Clarify the chairman’s role: CEO guidance and oversight, building, leading, and energizing the board in all its responsibilities, including legal and regulatory issues, financial integrity and reporting, compensation, executive and board member succession, and governance.
- ▶ Recognizing the complexity inherent in each role, facilitate a partnering approach in instances where the CEO and board chairman roles are not held by a single individual. When the roles are filled by one person, appoint a lead director to serve as the primary communications conduit between the board and the CEO/chairman.

## 7. Identify, Monitor, and Manage Evolving Issues

- ▶ Be cognizant of the lessons learned, day by day, to improve board effectiveness and governance quality.
- ▶ Brief board members and CEOs frequently to be certain they understand successes and disappointments being experienced by both successful and unsuccessful enterprises. Implement changes that materially improve performance.

## Contributors

It is important to BEP's Managing Partners to acknowledge the hundreds of hours others have invested with us to develop BEP's *Roadmap*. We have honored requests for anonymity from many of the over 150 clients and colleagues interviewed. Those who gave us permission to recognize their contribution include:

**Joseph W. Bartlett**, Fish & Richardson P.C., Of Counsel. Joe has decades of experience with governance and board effectiveness and provided invaluable insight . . . even before we established BEP.

**Harold W. Burlingame**, AT&T Wireless, Senior Executive Advisor, formerly Executive Vice President, AT&T. Hal is recognized for his concerns about corporate governance issues. Hal has worked with boards and corporations over the years and provided vital guidance in developing and communicating BEP's *Roadmap* and methodology.

**Robert L. Bush**, Robert L. Bush & Associates, Inc., Founder. Following government service, Bob has partnered with and served clients for over 40 years as a management consultant with his own firm and before that with Cresap, McCormick and Paget. His no-nonsense guidance helped ensure BEP stayed client-focused on "real" challenges and opportunities.

**Julie H. Daum**, Spencer Stuart, North American Business Leader. Julie is recognized worldwide for her competence in partnering with her clients to fill director vacancies. Julie provided guidance early in our search for best practices in board effectiveness, governance quality, and recruiting board members.

**Hal K. Herzog**, Medical Liability Mutual Insurance Company, Chairman of the Finance Committee and Member of the Board. Hal's insight has been priceless—encouraging pragmatism and creativity in designing new solutions to the new challenges facing boards and their members today and into the foreseeable future.

**Roger M. Kenny**, Boardroom Consultants, Managing Director. Roger and his firm produced the *Role of the Chairman*, which we have found invaluable in guiding new chairmen and clarifying the differences between CEOs and board chairmen. Founded in 1974, Boardroom Consultants was the first to specialize in governance consulting and director selection.

**Gregory E. Lau**, General Motors, Executive Director, Global Compensation and Corporate Governance. Greg is one of the leaders in developing and implementing policies and processes designed to strengthen board effectiveness and governance quality for GM.

**Dean B. Maglaris**, University of Vermont, Chairman of the Board. Dean encouraged the birth of BEP and has been generous in reviewing and helping us strengthen BEP's *Roadmap*.

**Thomas L. McLane**, Directorship Search Group, Vice Chairman. Tom collaborated with us very early in our search for "Board Governance 101." His experience with board searches and governance formed the cornerstone for our perspective.

**Stephen A. Sherwin**, M.D., Cell Genesys, Chairman and CEO. Steve was a vital, early contributor in our search for "truth" and pragmatism in governance and board effectiveness and in guiding us in developing BEP's *Roadmap*.

**John S. Struck**, Managing Director, Wand Partners. John was perhaps our toughest critic in encouraging us to be direct to ensure that BEP did not get bogged down in rhetoric at the expense of straightforward analysis and action.

**John P. White**, Ph.D., Harvard University, Lecturer of Public Policy. John, formerly Deputy Secretary of Defense and former CEO and board chairman, encouraged us with his experience, insight and wisdom, keeping us focused on the real issues important in strengthening board effectiveness.

**Roger M. Widmann**, Tanner & Co., Principal. Roger helped strengthen our analysis and methodology, leveraging his decades of experience as a board chairman and advisor to corporate leaders.

## A Foundation for Insight

The following is a partial list of publicly available reference resources BEP considers particularly valuable in understanding board effectiveness and governance quality. We continually analyze public and proprietary information that challenges or validates BEP's *Roadmap* and urge our clients and partners to do the same. Except for Web sites, resources are presented with the most recent at the top of the list.

- "Understanding Corporate Governance, Part 3," *Financial Times*, January 16, 2004.
- "Understanding Corporate Governance, Part 2," *Financial Times*, November 14, 2003.
- "Corporate Governance: How to Be a Good Director," *Wall Street Journal*, Carol Hymowitz, October 27, 2003.
- "Restoring Trust," Richard Breeden; Corporate Monitor, Report to The Hon. Jed S. Rakoff, The United States District Court for the Southern District of New York, on Corporate Governance for the Future of MCI, Inc., August 2003.
- "Understanding Corporate Governance, Part 1," *Financial Times*, July 4, 2003.
- "Introducing The Watchdogs For Corporate Governance," *Wall Street Journal*, Jeffrey Sonnenfeld, March 11, 2003.
- "Corporate Governance: Hard Facts about Soft Behaviors," *Strategy+Business*, Paul F. Kocourek, Christian Burger and Bill Birchard, March 5, 2003.
- "Corporate Governance: How to Fix a Broken System," *Wall Street Journal*, Carol Hymowitz, February 24, 2003.
- "Commission on Public Trust and Private Enterprise: Findings and Recommendations," The Conference Board, January 9, 2003.
- "Panel Presses for Division Of CEO, Chairman Posts," *Wall Street Journal*, Joann S. Lublin, January 9, 2003.
- "Review of the Role and Effectiveness of Non-Executive Board Members," Derek Higgs, January 2003
- "Signs of Poor Governance," *Directors & Boards*, Reginald Babcock, Winter 2003.
- "Disney Considers Creating Post of Presiding Director," *Wall Street Journal*, Joann S. Lublin and Bruce Orwall, December 2, 2002.
- "Boards Under Fire," *Harvard Business Review*, including the following articles: "Changing Leaders: The Board's Role in CEO Succession," Jay W. Lorsch and Rakesh Khurana; "What Makes Great Boards Great," Jeffrey Sonnenfeld; "Holes at the Top: Why CEO Firings Backfire," Margarethe Wiersema, December 2, 2002.
- Who Says Elephants Can't Dance? Inside IBM's Historic Turnaround*, Louis Gerstner Jr., 2002.
- "Sarbanes-Oxley: Some Practical Hints on Ways to Comply Effectively," *VC Experts*, Joseph Bartlett, September 9, 2002.
- Sarbanes-Oxley Act of 2002, July 24, 2002, <http://news.findlaw.com/hdocs/docs/gwbush/sarbanes-oxley072302.pdf>.
- "BRT CEOs Issue "Best Practices" Roadmap for Excellence in Corporate Governance Guidelines Proposed to Increase Trust in U.S. Companies," The Business Roundtable, Johanna Schneider, May 14, 2002.
- "What Directors Think," A Korn/Ferry International and *Corporate Board Magazine Study*, 2002.
- "The Impact on the Board of Directors of the Sarbanes-Oxley Act and Proposed Stock Exchange Listing Requirements," Heidrick & Struggles, 2002.
- "Secret to Today's Successful Young Companies, E-Board Strategies (How to Survive and Win)," Boardroom Consultants, Ram Charan and Roger Kenny, 2000.
- "Role of the Chairman," Boardroom Consultants.
- "Automatic Data Processing Corporate Governance Principles," Automatic Data Processing, Inc., [www.adp.com](http://www.adp.com).
- "Corporate Governance Guidelines," General Motors, [www.gm.com](http://www.gm.com).
- "TIAA-CREF Policy Statement on Corporate Governance," TIAA-CREF, [www.tiaa-cref.org](http://www.tiaa-cref.org).
- "Spotlight Topic: Boards and Directors," The Corporate Library, [www.thecorporatelibrary.com](http://www.thecorporatelibrary.com).
- "CalPERS Financial Market Reform Principles," [www.calpers-governance.org](http://www.calpers-governance.org).
- "Top Ten Questions Boardmembers Should Ask," AIG, [www.aig.com/directorsandofficers/html/nu\\_marketingtools.html](http://www.aig.com/directorsandofficers/html/nu_marketingtools.html).
- Directors & Boards, [www.directorsandboards.com](http://www.directorsandboards.com).
- National Association of Corporate Directors (NACD), [www.nacdonline.org](http://www.nacdonline.org).

# BOARD EFFECTIVENESS PARTNERS

## CLIENTS

The following is a partial list of the organizations served by BEP's Managing Partners, as consultants or executive leaders, prior to or since forming BEP:

American Express  
American International Group  
American Greetings  
Aon  
Apogee Enterprises  
AT&T  
Bank of America  
Bell Laboratories  
Boeing  
Bristol-Myers Squibb  
Cap Gemini Ernst & Young  
Cell Genesys  
CIENA  
Citigroup  
Continental Grain  
Corning  
Covisint  
EF Johnson  
Fulcrum Analytics  
Genzyme  
Getronics  
Greenwood Publishing Group  
Harmon Solutions Group  
IBM  
Independence Community Bank  
Johnson & Johnson  
J.P. Morgan Chase  
Kauffman Foundation  
KeySpan  
Kodak  
LexisNexis  
Lifetime Television  
Loehmann's  
Lucent Technologies  
Lydall  
Marsh & McLennan Companies  
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Verizon  
Veronis Suhler Stevenson  
Xerox  
Yankelovich

## Our Firm

Board Effectiveness Partners (BEP) collaborates with directors and CEOs to objectively analyze and improve the effectiveness of their boards.

BEP's business mission is to serve as the catalyst, enhancing board effectiveness and governance quality—enabling directors and CEOs to guide their companies to continuously improved performance and competitive superiority.

## Our Value

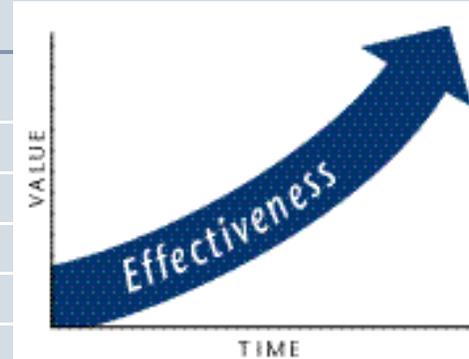
Continually Enhancing Performance

BEP Review and Implementation

Partnering with BEP

Committing to Effectiveness

Compliance



## **Managing Partners**

BEP's managing partners have an average of 30 years of experience as CEOs, board leaders, or consultants. With career credentials from manufacturing to financial services, and skills ranging from strategy design to implementing change, we provide the breadth and depth of professional background essential to strengthening board effectiveness. Our managing partners nurture relationships and work with senior, respected consultants to quickly field teams to strengthen governance quality.

**KEVIN ENGLISH** has devoted his career to leading business units, companies and boards and has improved corporate performance as a CEO and Board Chairman.

**JOHN MCCREIGHT** has dedicated over 35 years to consulting and partnering with CEOs, senior management, boards and investors in defining and implementing large-scale strategic change.

**MARK SCHNEIDERMAN** is a senior-level human resources professional who has held corporate leadership roles, and partnered with senior leadership and boards as a consultant, to facilitate strategy implementation and change management.

## **Alliance Partners**

BEP nurtures relationships with over 100 Alliance Partners who exemplify preeminence in their fields and complement our core competencies. Alliance Partners strengthen our capacity to improve board effectiveness and governance quality.

## **Research & Operations Center**

Our Research & Operations Center (ROC) professionals are linked worldwide to our clients, Alliance Partners, industry experts and the academic community. They focus daily on monitoring board effectiveness facts, opinions, successes, disappointments, lessons learned, and best practices.