

Capitalize On Your Board Transitions

by Lana J. Furr and Richard M. Furr, Ph.D.

In many boardrooms, a director retirement, change in board or company leadership, or shifts in committee composition are unplanned, often unwelcome, and handled without thought. Yet these times of change can be rich opportunities for board and executive renewal. Seize these dynamic moments to weigh your governance needs, and how talent and structures can be reshaped to meet them.

It was the perfect opportunity to evolve the board. The retiring chairman was going to assume emeritus status, and the board could elect a new chair to address the board's inertia. The board had earned a reputation for micro-managing. Directors were divided into two camps on most strategic issues, and several of the board members had "retired in place."

The board had two strong candidates for the chairman's role; both were CEOs, highly knowledgeable and engaged in board business. Another candidate had been on the board for 15 years. He was a good friend and staunch ally of the soon-to- retire chair and the son of a former chair of this board. The retiring chair spent time building a coalition of board members to support his friend and ally. He assured his coalition that his candidate would not upset the status quo. A majority of board members apathetically voted to approve the retiring chair's anointed candidate.

This story, or one similar, happens routinely. This board missed an opportunity to resolve issues hampering its effectiveness. Tradition, inertia and a desire to maintain the status quo in relationships prevail in board decisions to the exclusion of building transparency, establishing a meritocracy and enhancing board performance. By perpetuating the status quo, the board threatens the company's survival in

an increasingly complex world.

Board *cultures* create this tradition-bound inertia. In the absence of a proactive strategy to change board culture, directors who see the need for changes in their boards must be alert to key opportunities to evolve their board's talent and practices. Several transitions provide those opportunities. The selection of a new CEO or chair, board members, committee members and chairs, and setting new board policy can be watershed events—if directors see and seize the transitions as opportunities.

Directors too often succumb to peer pressure instead of taking a stand for meritocracy in electing a board chair.

□ *Succession of the chairman.* The introductory example of how many chairmen are elected reveals the strength of current culture in many boards. Directors, who have built brilliant careers based on their business acumen, succumb to peer pressure instead of taking a stand for meritocracy in the election of the chair.

One form of pressure is negotiation to name the CEO as chair. While the pressure still exists, particularly during recruitment from the outside, this trend is changing. According to the 2009 Spencer Stuart Board Index, ten years ago, 20 percent of S&P companies had a separate chair and CEO, but today that number has grown to 37 percent. Directors who feel strongly that the roles should be split are growing in numbers and influence. They have experienced the paradox a board faces when its employee/CEO is its leader, especially when there is a question about the CEO's performance.

Richard M. Furr, Ph.D. and Lana J. Furr are co-founders of Furr Resources management consultants, Greensboro, North Carolina. [www.furrresources.com]

The other pressures directors experience come from the desire of chairmen to select their own successor, CEOs selecting the person they most want to work with, or from influential shareholders. Adding to these pressures, most boards have not purposely recruited and developed a strong “gene pool” of chair candidates (often due to assuming that the CEO would be the chair). Then, when it is necessary to select a chair, the pool of potential board leaders is weak. Finally, the selection of the chair needs to align with how directors think their board needs to mature as a team and with the company’s strategic direction.

Why do so few directors challenge the process of how chairmen are recruited, developed, nominated and elected? More often than not, the selection is an underground process, with the retiring chair nominating a candidate that has been entirely vetted behind the scenes. Directors “go along to get along.”

Best practices encourage a more transparent process, one in which several candidates can come forth and compete on their merits, with the most capable winning the election. Several workable election processes yield positive results for directors who genuinely seek the best possible leader.

In interviews, directors often report that they have had no role in the chair succession process and do not expect to have more than a cursory vote in the future. Given the exposure of directors and questions asked by shareholders, the chair succession process is due for a review by many boards. A transparent process that helps directors define the competencies most needed in the next chair, and discern who best possesses those competencies is ideal.

Board members owe it to shareholders to ensure CEO succession planning is done and a decision is based on merit.

□ *CEO succession.* Executive placement firms say that up to 40 percent of outside hires fail within the first 18 months due to a lack of understanding about the company’s culture. In the following example, the board missed its opportunity to ensure the company’s future through conscientious succession planning.

The board had to hire an outside turnaround expert to lead the company while they sought a new CEO. The directors admitted they had been complacent in allowing the CEO so much unquestioned authority in his decision making. When a series of bad decisions brought the company to the brink, the board ousted the CEO without having any internal candidates to be the CEO and without an emergency succession plan in place. Will the outside hire they bring in be the leader they need?

According to the 2009 Spencer Stuart Board Index, CEO succession is discussed at least annually by 55 percent of the S&P companies participating in their survey. However, 30 percent do not have a long-term succession plan. In fact, 12 percent of the companies do not even have an emergency succession plan in place. Are any of your active shareholders asking about your succession plans yet? Are you getting questions about the job the current CEO is doing? How much would you invest in a company whose board does not plan for the future and stability of the company?

Despite the need for exceeding discretion during succession planning, board members owe it to shareholders to ensure that the planning is done and that the process ensures a decision based on merit. While each director may not know the name “in the envelope” for an emergency, board members should know who is responsible for the planning, and should feel personally assured that it has been responsibly accomplished.

Long-term succession planning is frequently delegated to the board’s HR/compensation committee or nominating/governance committee, either of which can be a logical choice. While the two committees should possess necessary competencies to facilitate the planning, the board as a whole should not abdicate all responsibility in the planning process. According to Spencer Stuart, 42 percent of S&P boards manage the succession planning process by the entire board (another logical choice given what is at stake).

In fact, all directors should have a mechanism for giving input on the competencies needed in the next CEO, especially in connection with the company’s

Ranking CEO Competencies

The Right Skills For The Right Job

Rate each of the competencies below as *essential*, *important* or *nice-to-have*. Add competencies you think should be added if you do not see the skill, knowledge or attitude reflected in the definitions. You will not find all of these competencies to the same degree in one candidate. Therefore, it is unrealistic to rate everything essential. Seek a blend of all three ratings.

Competencies	Essential	Important	Nice-to-have
Emotionally intelligent	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Integrity and trustworthiness	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Track record with capital markets and analysts	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Developer of talent	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ability to communicate with all constituencies and the media	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Leadership	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Visionary; thinks strategically	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Financial and business acumen	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Industry/regulatory knowledge	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sales and marketing expertise	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
International experience	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Superior judgment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Organizational acumen	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Perseverance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Active presence in the business community	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

strategy and the culture needed to support the strategy. The opportunity for boards to be more active in succession planning has never been more appropriate than in the current economy. Each director is responsible for ensuring that the talent planning process is on track to be implemented whenever needed.

Board talent. While CEOs cannot expect long tenures today, directors usually expect to be re-elected until retirement. It often takes a company crisis, a strong personality clash or malfeasance to

precipitate director removal or replacement before retirement. According to Spencer Stuart, the average age of S&P board members is increasing, with about 29 percent of boards having an average age of 64 or older. Over half of directors who left boards in 2009 were due to retirements.

Furthermore, few boards seek new members. Most want directors who already have experience on other boards (although experience does not necessarily equate to effectiveness). This means that boards

are seeking director talent from a very limited pool.

With declassification, boards have more frequent opportunities to step back and look at the composition of the board with a fresh and frank appraisal. The board's makeup should evolve to align with the company's strategic direction just as the CEO needs to be selected with strategic vision in mind. Boards have many tools they can use to support this practice, such as using a director skills matrix and peer evaluation.

A director skills matrix should be developed based on the competencies needed on the board in support of strategy. Particular attention is paid to those skills and abilities needed by at least one director (with less focus given to those competencies expected of all directors). The matrix is completed by establishing which directors possess the needed competencies. Gaps are used to identify recruiting needs for the next director election.

Director peer evaluation is a compelling and objective method for building board meritocracy. When administered by a neutral and professional third party, each board member learns his or her relative standing among peers using a yardstick of expectations established by all directors in advance of the process. Directors should not see others' results. The results are given to the nominating/governance committee. Those members judged by their peers to be contributing the least to the board's work may need "coaching," or may be vulnerable to being asked to stand down during the next election.

Boards who use peer evaluation report an increase in director performance. Much like our Congress, many directors place self interest above what is best for the organization.

Fewer than 20 percent of boards have the courage to use these tools. The boards who decide to use peer evaluation report an increase in director performance and contributions. When we have worked with board clients who consider, then decline, to pursue peer evaluation, a few directors state that they do not believe that they need the process. Some

directors believe that they are above being evaluated at this point in their career. Others report that their colleagues cannot manage their personal fear of the process, but that it is strongly needed. In fact, surveys indicate that 80 percent of directors believe that peer evaluation of directors is needed.

Much like our Congress, too many directors place their self interests of continuing to hold the board seat ahead of what is best for the organization. Since they do not recognize when it is time to step down, the board needs to act, or it misses the opportunity to build a board based on meritocracy.

□ *Committee membership and chairs.* When committee appointments are confirmed following each director election, the board has an opportunity to manage the transition for the long term.

The committee chairman was the longest serving director on the board—a cherished "fixture," to use the words of the new CEO. He was in failing health, however, and other directors watched him struggle to make board and committee meetings. His committee reports to the board were cursory, and his committee meetings were perfunctory in nature. Management had to assume more of the work that should have been done in the committee. The lead director was struggling with the knowledge that he had to ask the director to retire, but it was hard to do since that board had a tradition of never having asked anyone to step down prior to the retirement age.

Committee appointments are one of the best director development tools the board has. Insightful boards recognize the value of in-depth exposure to various aspects of the company. They also see the potential for developing board leaders for succession to chair or lead director through committee leadership.

Boards attuned to best practices rotate committee memberships with some regularity. There is an old argument that board members need to remain on the same committee *ad infinitum* to gain adequate expertise. We challenge that position because most directors of major companies have the ability to learn quickly and will contribute to the "heavy lifting" of a committee within a year. Also, without rotation, they become bored with repetition.

Board Culture Survey
Shaping A Dream Team

Rate your directors on each of the following behaviors that shape board culture. Use the following ratings:

- 4 — All of our directors exhibit this behavior consistently.
- 3 — Most of our directors exhibit this behavior consistently; others sporadically.
- 2 — Some of our directors exhibit this behavior some of the time; others not at all.
- 1 — This behavior is not observed in our board.

The individual directors on our board . . .

Work well individually as experienced executives and cooperate with others in the board team/meeting environment.

Will commit the company to reasonable and measured risk.

Accept the view that constructive conflict is healthy and will disagree agreeably and in ways that result in effective problem-solving.

Display selfless interest, engagement and effort in order to make a productive contribution and do what is best for the organization.

Operate with respect for the boundary between the work of the board and management and for each others' areas of expertise.

Contribute creative and practical ideas to the strategic thinking and planning role of the board and management.

Understand the traditions operating in the board, follow those that contribute to performance, and challenge those that do not result in productivity and a meritocracy.

Will courteously raise questions that challenge the thinking of management and the other directors when critical considerations are being overlooked.

Prevent disruption by displaying appropriate energy and intensity in their communications and demeanor when both routine and high stakes issues are discussed.

Hold each other accountable for doing what they are expected to do and for making an individual difference in board performance. They expect consequences for negligence or poor performance among directors.

Trust each others' intentions, preparation and competencies in decision making.

Maintain a directional course based on thorough research and dialogue and do not rehash decisions based on personal preferences and idiosyncrasies.

If you have assigned 2s or 1s to any items, the culture of your board likely interferes with performance in some way. Also, most boards have blind spots, so your ratings may be overly optimistic. It would be valuable to know how your CEO would rate the board, given its effects on management, or how a neutral observer would rate your board.

While not a mandate, it is a healthy guideline to move directors among committees every three to five years, and to rotate committee chairs to a new committee every five to seven years. Effective directors report that they appreciate the opportunity to gain more exposure, and that they are better equipped to make decisions at the full board level.

Committees who select their own chair report high levels of satisfaction with the chair's performance. Members, who are affected most closely by the selection, have the best insight into who can lead the committee with greatest efficacy. At a minimum, the board benefits from having a process that takes member opinion into account when the committee chair is appointed.

CEOs have confided to us that the nominating/governance committee can become the collection point for weaker directors. Then, when there is a difficulty to be handled by that committee, some CEOs do not feel confident they have a resource for solving the problem. The belief is that the "stronger" directors are being "saved" for service on the audit and compensation committees.

It becomes especially problematic during times when there are director performance issues (or when board turnover is needed), when succession planning is in demand, when new and "difficult" board policies need to be enforced, or when new directors need to be recruited. It also sustains the inertia that results by retaining weak directors who should be asked to step aside at the next election.

□ *Changes in or enforcement of policies or practices.* We often advise boards when directors are trying to rectify the effects of earlier decisions. The basis for sound decisions is rooted in shaping thoughtful policies, then holding members accountable for following them.

Directors frequently miss the opportunity to benefit from their retirement policy if they lack the will to follow it personally. We have worked with boards that have grandfathered their directors from the retirement age. They then must cope with diminishing capacity, fewer able directors to do the work, heightened liability, absenteeism and even the death of board members.

Another missed opportunity is the lack of accountability built into policies and board practices for ongoing director education. Many boards and governance committee chairs look the other way. Directors who do not make the time to do the job well and to maintain a high level of competence in the ever-changing world of governance should not stand for re-election.

One final missed opportunity is the lack of true director independence. Selecting directors remains a closely-held process despite the use of "independent" nominating committees. Instead of pursuing the most outstanding competencies available, social relationships continue to drive nominations. When hidden interlocking relationships exist on boards, decisions about executive pay, etc. lead to the shareholder activism that is growing today. Directors who are beholden to the CEO will have a difficult time creating a meritocracy on the board, and governing themselves and the company well.

Boards that pursue a true meritocracy will attract and retain the best talent.

Why focus attention on transitions to "upgrade" the board's practices? Transitions are the most logical time to try something new. Some level of change is already a given. Bridging the gap necessarily demands deliberation and time on the agenda.

Within the board, there are likely several directors that see the benefits of questioning the status quo. They simply need the courage to speak their minds, and the support of board leadership and fellow directors for doing so. They should find support among more progressive directors to at least call the question. Boards that operate with highly-effective practices and transparency, and which pursue a true meritocracy, will ultimately attract and retain the best talent. The very best directors want to serve on an "A" team. It is a matter of governing the board with the same diligence as the company. As Philip Massinger so eloquently stated, "He that would govern others, first should be the master of himself."