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Not the usual suspects: How to use board process to make boards better

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Executive Overview

Research on corporate boards and board reform efforts alike have been dominated by a concern for board independence and its effect on the monitoring of the CEO. However, attention to what we call the "usual suspects"—the number of outsiders on boards, director shareholdings, board size, and whether the CEO also holds the Chair position (CEO duality)—does not yield either strong research results or more robust corporate governance in practice. In this article we argue that the "usual suspects," as measured by the classic indicators, do not ensure a truly independent board and that the key to making boards work better rests in an area largely ignored by researchers: board process. Based on structured interviews with members of corporate boards, we open a window to what is really going on inside boardrooms. Our analysis suggests five critical goals for which all boards should strive and presents a detailed checklist of recommendations for directors on how best to realize these goals.

Boards of directors play multiple, and critical, roles in organizations. Boards are primarily responsible for (1) providing oversight, advice, and counsel to CEOs, and (2) monitoring and if necessary disciplining CEOs. While the former role has not been the subject of as much research as the latter, the independence of the board of directors has been seen throughout as a centerpiece to effective corporate governance.[1] Remarkably, research on board independence, as well as efforts to improve board effectiveness in corporate governance circles, has coalesced around identifying what we call the "usual suspects"—few outside directors on the board, insufficient share ownership by directors, boards that are too big, and CEOs who also serve as board chairmen. Outsiders are expected to be more vigilant than insiders because they are purportedly less dependent on the CEO and are the formal representatives of shareholders.[2] Directors who own stock have "skin in the game," providing an incentive to pay close attention.[3] Smaller boards can avoid the inefficiency that characterizes many bigger boards.[4] And the separation of the CEO and Chair positions can limit the power of the CEO to control the board and its agenda.[5]

This fixation on the same dominant problems is odd, however, when we consider that, with the exception of CEO duality (where the same person holds both the CEO and Chair positions), a dramatic shift has been taking place in corporate governance in the United States. According to our study of firms in the Standard & Poor's (S&P) 500, outsiders now account for 75 per cent of directors on the average board; only the CEO and perhaps one other top manager sit as insiders on the typical board. Directors are also highly compensated with stock; on average, 91 per cent of the directors on each S&P 500 board own stock, and 56 per cent of the S&P 500 boards are comprised entirely of directors with shareholdings. Average board size has dropped from about 16 directors in the 1980s to 11 today. Only CEO duality remains high (78 per cent of S&P 500 firms).

There is just one small problem with the logic of the usual suspects—it doesn't work! Support for this contention comes from two sources. First, each of these levers for independence does not work nearly as smoothly as often assumed. For example, many outsiders are beholden to the CEO because they or the firms they represent transact considerable business with the CEO's company.[6] Further, Josh Weston,[7] honorary chairman and former chairman and CEO of ADP, actually told us that stock ownership does not affect behavior but "it's good to have because it looks good on the proxy statement."[8] Similarly, ending CEO duality (where both CEO and Chair positions are held by the same person) risks sending mixed signals to the market regarding who is really in charge at the top. It is also not hard to imagine how boards may find it difficult to attract top quality talent to the CEO position when a sitting independent Chair is part of the package. Both Louis Gerstner at IBM and Larry Bossidy at Allied Signal insisted on the joint positions before accepting their offers.[9] In sum, when one looks more closely at each of the classic indicators of board independence, it becomes apparent that their ability to clearly make corporate governance a success is misleading.

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Second, the S&P 500 data enabled us to examine more closely the relationship between the classic metrics of board independence and what they are ostensibly designed to support: shareholder returns. We conducted two tests. In the first, we computed the industry-adjusted fiscal year 2000 total return to shareholders for all S&P 500 firms using data from COMPUSTAT and then compared the upper and lower quartiles in terms of how they scored on board independence. Result: no significant differences in the number of outsiders, director shareholdings, board size, and CEO duality between high and low performers (see Figure 1).

In the second test we honed in on a "rogue's gallery" of select firms—Enron, WorldCom, Global Crossing, Quest Communications, and Tyco—to see whether they too adhered to the "usual suspects" approach to corporate governance. Using data collected from proxy statements filed in the year before scandal publicly hit each company, we found that the boards in all five firms had almost uniformly "stellar" credentials (see Table 1). Hence, whether one considers the entire S&P 500 or just a select group of troubled firms, the result is the same—the benefits of board independence seem to be rather illusory. Most boards are "independent," yet independence assessed in the traditional fashion is unrelated to firm performance.[10] Unfortunately, many of the recent reforms spearheaded by Congress and the SEC include exactly

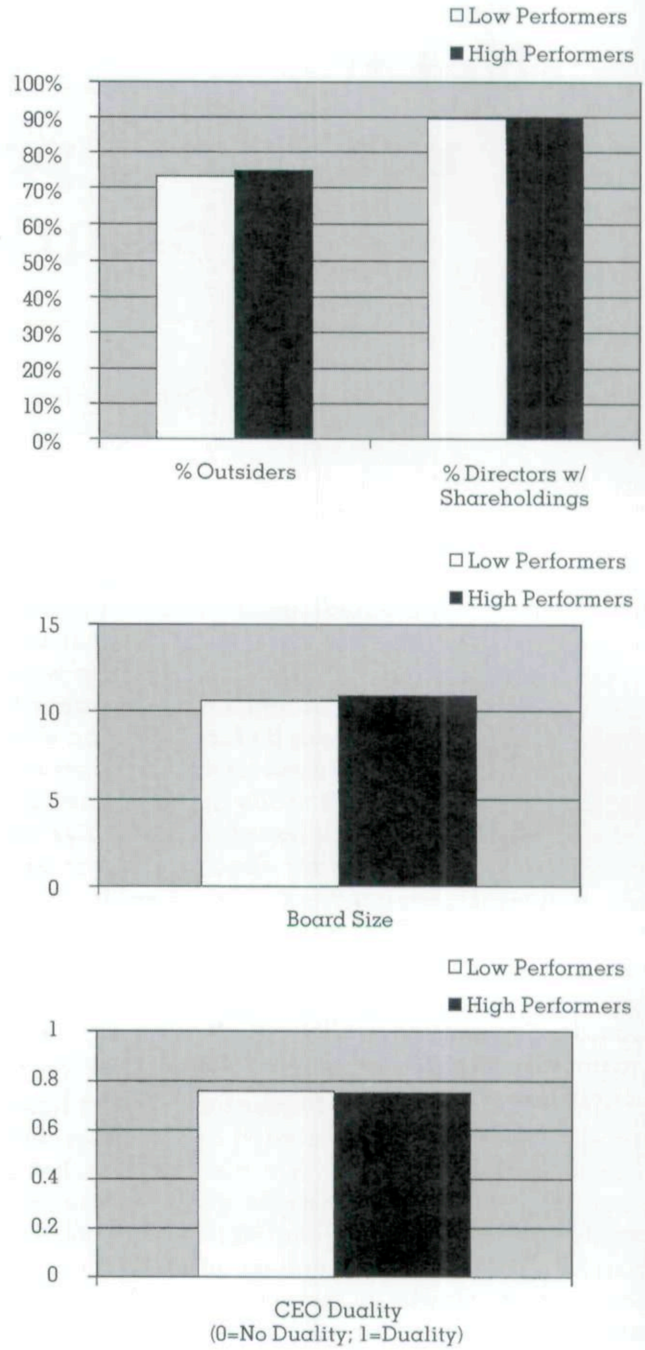

FIGURE 1
Comparison of the "Usual Suspects" in Low and High Performing S&P 500 Firms

these recommendations; yet an even more fundamental approach to improving corporate governance remains buried while academics, consultants, and reformers pursue the holy grail of independence.

In this article, we offer an alternative perspective on boards of directors that starts with the simplest of premises: the ability of a board of directors to do all the things scholars and corporate gover-

Table 1
The "Usual Suspects" in Selected Poor Performing Boards

Company	% Outsiders	% Directors w/ Shareholdings	Board Size	CEO Duality
Enron	86%	100%	14	No
WorldCom	75%	100%	12	No
Global Crossing	73%	91%	11	No
Qwest Communications	64%	92%	14	No
Tyco International	73%	100%	11	Yes

nance experts advocate depends on the quality of the individuals who become directors and their ability to get the work of the board done as a group. The insight that boards are groups, and hence that such group processes as conflict, teamwork, and comprehensiveness are critical determinants of board effectiveness, opens up a new tack on how to improve board effectiveness. Rather than simple counts of insiders and outsiders, a focus on board process suggests that the nature of the interactions among board members influences their effectiveness in fulfilling the key roles of advice and counsel for, and monitoring of, CEOs.[11]

Our aim in this article is to develop these ideas in the context of corporate governance today, where boards have evolved to embrace many of the basic attributes of effective governance advocated by scholars and other experts. The next section identifies five critical process goals for boards. The central challenge after that is how to achieve these goals, which we address in detail by offering a checklist of recommendations to improve board effectiveness.

What Is Board Process and Why Is It Important?

If you want to understand board process and effectiveness, you have to talk to the people who sit on boards. We conducted thirty-two structured interviews with directors who, despite concerns for confidentiality, spoke candidly with us about their board experiences, yielding insights on what really makes boards work or not work. Consistent with our premise, these directors did not talk of "board independence" in a sterile fashion but emphasized the multitude of ways in which directors interact and behave as they fulfill their duties. Out of these discussions came a clear picture of board processes and how to execute on them. Board effectiveness requires that five interrelated process goals be realized: (1) Engage in constructive conflict; (2) Avoid destructive conflict; (3) Work together as a team; (4) Know the appropriate level of strategic involvement; (5) Address decisions comprehensively.

Goal #1: Engage in Constructive Conflict (Especially with the CEO)

Every one of the directors we interviewed mentioned the importance of constructive conflict, which occurs when directors hold and debate diverse views among themselves and with the CEO. Such exchanges help the board better understand issues surrounding the decision context and synthesize multiple points of view into a decision that is often superior to any individual perspective. In other words, as is true with other groups,[12] constructive conflict improves decision-making in a board and is an important determinant of effectiveness.

Although all of our directors underscored the importance of constructive conflict, several process issues made this a difficult goal to achieve. Dave Wathen, a director with years of experience on boards, said that in one case managers were slow to adapt to changes in the industry, and "we, the board, did not force them to act sooner. The lesson learned—and we learn this all the time—is be faster and more aggressive in dealing with management missteps. We didn't act quicker because we don't like conflict."

Board members' willingness to challenge management has much to do with the CEO. Paul Fulchino, CEO of Avial, asserted that at one extreme you have CEOs that want a "bunch of lap dogs—guys that basically just say 'yes sir, yes sir'" and at the other extreme, CEOs aren't allowed to make a decision on their own, so "every little thing that comes up, the CEO has to check with the board." Indeed, our directors offered many examples of the first extreme: dominant CEOs who discourage constructive conflict. One person we interviewed noted that at his company the former CEO "wasn't really looking for input as much as he was looking for approval" from the board. Josh Weston, former CEO of ADP, said, "CEOs in certain companies like to manage the news, don't want anything rocking their boat, and will try to unilaterally determine the agenda and everything that comes up."

Unfortunately, many interviewees noted that not all directors stand up to dominant CEOs. When there are insiders on such a board, few will openly challenge their boss. Referring to an internal board member (the CFO), one director told us, "I think because his boss is sitting there . . . he wouldn't say anything that would be in direct conflict with an opinion held by his boss. So I take them somewhat as a unit." Outsiders can also buckle under the pressure of a dominant CEO. In one director's opinion, "The most annoying thing to me in boards that I have served on has been what I call the applauding director . . . someone who can't find enough ways to tell the CEO how well they are doing . . . it's called brown-nosing."

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A lack of constructive conflict, however, might not always have to do with the CEO. For example, one director told us, "I often get the board packet the night before I leave for the meeting, so I don't have enough time to fully understand the issues. As a result, I am less likely to challenge what's going on and more likely to defer to the CEO." Furthermore, even if directors are able to prepare for meetings, too many told us that board meetings are "jam packed" and "overscheduled," providing little opportunity for debate.

In summary, although most directors agreed that challenging each other and the CEO is important, boards don't always do it. As one director of a major retailer told us, "Most boards are not as inquiring as they should be. Either they don't know that much about the subject even though they should have done more homework, or they feel shy challenging the CEO."

Goal #2: Avoid Destructive Conflict

Constructive conflict can pit one director's views against another's, and while open discussion has clear value, sometimes such task-oriented, constructive debates are taken more personally. For example, board members who are not used to being confronted as an ordinary course of business might feel threatened when other directors challenge their ideas. When personal and emotional considerations gain prominence, constructive conflict spirals into destructive conflict, degrading group decision-making and interfering with the board's ability to perform its key roles.[13]

Although twenty-five (78 per cent) of the directors we interviewed stressed the importance of keeping conflict constructive, personal friction and tension in the boardroom—destructive conflict—does occur. Paul Foster, the former CEO of Tandy Industries, related that the "dynamics of our board changed dramatically after the proxy fight when two dissident board members joined. Prior to that there was a lot of open and free dialogue. When they came on board, it was clear they were working not with us but against us."

Destructive conflict can emerge not only when there are issues of corporate control but in the everyday activities of boards. Directors can have strong views, and when they are not balanced with a degree of tolerance and open-mindedness, they can disrupt how the board works together. For example, a computer company CEO we interviewed recalled how personal tensions among directors escalated when one director's concern for employee morale was seen as "irrelevant" by the rest of the board. Another CEO told us how the board reacted against his desire to bring in a new, relatively young board member, in part because of a justified concern that the person was too inexperienced but also as a reaction to the person who was leaving the board. The new director was to replace a prestigious outside board member, and the board wanted a director of equal stature or, as the CEO put it, "Jesus Christ himself."

Finally, there is an inherent tension between reducing destructive conflict on a board at the same time that constructive conflict is being promoted. Destructive conflict personalizes a dispute by making it less about solving an overarching group problem and more about the individuals involved. Despite their lofty positions, board members are people, and they are subject to the same biases and behaviors that all of us are. In the end, however, the combination of constructive conflict without destructive conflict is a priority for successful board process, and boards that cannot master these dual goals simultaneously will suffer.

Goal #3: Work Together as a Team

A central component of board process is teamwork, which came up in twenty-seven (84 per cent) of our interviews. Since board members, like top management teams, are confronted with complex and ambiguous strategic decisions, they too are required to work together by sharing information, resources, and decisions.[14] Boards that are unable to work in partnership not only end up less able to rein in powerful CEOs; they are also less effective at providing the advice and counsel at which more collaborative boards excel.

Unfortunately, boards often do not act like teams. Developing strong team norms is difficult because boards spend little time together and, hence, have few opportunities to coalesce as a group. Most directors we spoke to said they attend about four to six meetings a year, with directors flying in the night before and meeting the following day. Although spending more time together might seem like a good solution, it's not—many of our directors stressed that their boards already require too much time from them. The challenge, rather, is making the most of the time boards have to develop team norms naturally.

Another factor that might hinder a board's ability to be a strong team, according to our interviews, is the relative distribution of influence among board members. As Paul Fulchino put it, "If you threw five dogs in a room, they would be very clear about who the senior dog was and who the junior dogs were." John Cook, chairman and CEO of Profit Recovery Group, agreed and said that a director's power has to do with professional background and personality. He explained that "anytime you have a group, you have certain personalities that are more or less leaders and, thus, have more influence over other members."

Power that is based on expertise is considerably more legitimate, and few boards should disregard relevant expertise when it is there. At the same time, though, boards need to learn how to avoid doing so at the expense of other board members' valuable contributions. This is particularly true with new directors. When new directors step in "cold," the odds are, as one interviewee told us, that they will "stay quiet for a few board meetings. Some regrettably stay quiet for a long, long time."

The bottom line on board teamwork is to avoid having a small number of dominant directors take over deliberations. Not only does this deprive the CEO of feedback and advice from less central directors, but such boards can also degenerate into fiefdoms that are unwilling to share expertise and information across boundaries. As Stanley Gault, the retired CEO of Rubbermaid, said, "If you have chemistry problems within the board, you can expect to have functional problems as well." The net result can be board decisions made without the full participation of members, which is nobody's idea of good governance.

Goal #4: Know the Appropriate Level of Strategic Involvement

All boards vote on major strategic decisions. However, what one board deems as "major" may be very different from another board. Further, some boards may get involved with more issues and decisions than just major strategic decisions. In short, the strategic issues with which the board is involved will vary, often in ways that affect not only how boards work as a group but to how boards perform.

Every one of the directors we interviewed brought up this point, noting the increasing importance of strategic involvement as the expectations of boards change. The CEO of a financial services company told us that "today's directors have to go further than just monitoring the CEO—they have to become deeply involved in understanding what the company is doing. There is just too much liability for directors that don't pay any attention to what's actually going on." This presents a dilemma, as described by D. R. Grimes, chairman and CEO of NetBank: "There is a little bit of a philosophical change here. The outside world is beginning to hold directors more accountable, and directors do have day jobs. Where do you cross that line between oversight and micro-management of the company?"

Indeed, many of the board members we interviewed stressed that boards should not be overly involved in the firm. As Josh Weston of ADP said, "I don't think it should be for every board member to be an internal busybody." A consumer products CEO we interviewed put it this way: "Some boards take some liberties and encroach upon management's role [by saying things like] 'here's who you should hire, here's who you should use, here's a decision you should make.'" Directors noted that this tendency is a particular concern when the CEO is newly appointed. CEOs need time to establish their vision and priorities, and excessive board pressure could lead to a revolving door at the top.

The proverbial leash, on the other hand, must be tightened when the corporate outlook turns downward. This is especially true because CEOs under attack tend to circle the wagons and cut back on new or varied sources of information.[15] The biggest challenge for boards is to identify those early warning signs that something might be amiss and then act on them. The experience of boards in companies such as Enron, K-Mart, and WorldCom suggests that the burden of proof may well have shifted toward ever-closer board involvement.

Goal #5: Address Decisions Comprehensively

Finally, all of the interviewed directors emphasized that if a board deems a matter important and strategic enough to require their involvement, they must make the effort to address that decision comprehensively. The problem is, however, that boards often tackle problems in a less than comprehensive manner—they often address decisions with little depth, avoid seeking help from experts, and limit their exploration of decision alternatives.[16]

How comprehensive boards are in delving into a decision depends on numerous considerations but especially the financial condition of the company and the potential risks that might emerge. When the margin for error is small because of financial difficulties, greater scrutiny is called for. This is one of the reasons that the Mattel board was so criticized after they allowed then CEO Jill Barad to continue missing earnings targets quarter after quarter. And this is also one of the primary reasons that the Enron board is going down as a textbook example of what not to do—board approval for a myriad of off-balance-sheet partnerships and other arrangements was apparently given with only the most cursory of investigations.

As such incidents have received notoriety, board members appear to be moving toward a deeper appreciation for the value of decision comprehensiveness—so much so that some executives shy away from directorships because they feel it's too difficult to add value. For example, even Robert Galvin, former chairman and CEO of Motorola, who would be seen by many as an ideal director based on his experience, expressed his reluctance to join boards: "The reason I have not gone on other boards was that I never felt, knowing what I knew about Motorola—and I was very hands on—that I could ever know enough about the other company to be relevant in my advice to the chief executive officer. If you want to talk generalizations, fine, call me and we'll have a drink together, and I'll do that every couple of years."

In sum, addressing decisions comprehensively, like the other four key goals we identified, is really at the heart of what it takes to make successful corporate governance happen. The dilemma is that, as described above, there are numerous challenges to achieving these five goals. This is because the goals that define effective board process are really all about the people who sit on boards, making them considerably more messy and complex to achieve than, for example, just adding more outsiders. Despite this challenge, however, there are many steps directors can take to get process right.

An Action Plan for Improving Board Process

Given that the five process goals presented in the previous section are so critical to board effectiveness, we spent the lion's share of our interviews probing our directors on these points. In addition, we looked at related research on groups, top management teams, and decision-making to fine-tune our thinking. Most of the recommendations that emerged from this analysis were helpful in advancing more than one process goal and, in some cases, addressed all five goals. For example, as we discuss below, formal evaluations of the board can help directors achieve all five process goals. As a result, we put together all of our recommendations in a checklist that spans multiple goals (Table 2).

Formal evaluations of the board can help directors achieve all five process goals.

Selection: Get the Right People

Boards are only as good as the people who sit on them, and several directors pointed out that the selection process should not be dominated by the CEO.[17] Rather, the incumbent board members should *be actively involved in selecting new board members.* This involvement has the salutary effect of enhancing their support for the new people, creating an incentive for sitting board members to integrate newcomers into the larger group. Involving all directors also avoids exclusionary feelings that can create tension.

When working together to select new directors, our directors repeatedly stressed the importance of opting for directors with *strategically relevant experience.* As Charles Elson, director of Sunbeam, put it, "The key to creating a monitoring mechanism [is to have] folks on the board with expertise in different areas, whether it be finance, marketing, general management, retailing, international, [or] accounting." For example, one experienced director said that "if you want to understand housewives, then you'd better have somebody who understands housewives sitting on the board; if you're going to depend on innovation, then you'd better have some free-thinking and imaginative people in there." And Russell Lewis, president and CEO of the New York Times Company, told us that

Table 2
Checklist for Effective Board Process

Goal #1: Engage in Constructive Conflict
Goal #2: Avoid Destructive Conflict
Goal #3: Work Together As a Team
Goal #4: Know the Appropriate Level of Strategic Involvement
Goal #5: Address Decisions Comprehensively

	Goals				
Board Action Items	#1	#2	#3	#4	#5
Selection: Get the Right People					
Be actively involved in the selection of new directors		√	√		
Look for directors with strategically relevant experience	√			√	√
Select directors with strong communication skills	√	√	√		
Consider the personality of potential directors		√	√		
Ensure that new directors will have the time to serve	√	√	√		√
Structure: Put Meaningful Structure in Place					
Avoid unnecessary divisions among directors		√	√		
Communicate between board meetings, especially with CEO			√		√
Appoint a lead outside director	√				√
Regularly evaluate the board and CEO using performance metrics	√	√	√	√	√
Set term limits to keep the board fresh	√			√	√
Staging: Set the Stage for Effective Board Meetings					
Establish criteria for the strategic decisions that the board will address		√		√	
Clarify rules of behavior	√	√	√		
Help new directors get assimilated on board		√	√		
Demand adequate time to prepare for meetings	√	√			√
Ensure that materials received for board meetings are meaningful	√			√	√
Ensure that meetings are not overscheduled	√	√	√		√
Periodically hold meetings "in the field"				√	√
Steering: Steer Board Meetings to Improve Board Process					
Keep a close eye on management and have the "guts" to disagree	√				√
Talk to people who are directly involved in decisions				√	√
Solicit help from outside experts	√			√	√
Meet without the CEO	√			√	
Promote devil's advocacy to explore alternatives	√				√
Solicit feedback from more junior, and less vocal, directors			√		√
Encourage facilitation techniques to maximize contributions	√	√	√		√
Regularly ask CEOs big-picture questions				√	
Perform scenario planning					√

√ = Although each action item might arguably address all five board process goals, a checkmark indicates that the action item is likely to be especially helpful in assisting boards to achieve that board process goal.

he and his board try to get directors with "a diversity of professional backgrounds that pertain to our business, and we also try to get a diversity of folks from a gender and ethnic point of view because we think that is important and mirrors what we are doing at the business level."

Directors valued strategically relevant experience not only because such members are more likely to engage in constructive conflict by offering informed but differing points of view but also because they are more likely to improve decision comprehensiveness by adding richness to discussions. As John Cook, CEO and chairman of Profit Recovery Group, said, outside board members' knowledge and skills should complement those of the CEO and top management, providing a richer consideration and resolution of strategic issues.

Board members also stressed the importance of evaluating the *communication style of potential directors.* Can they explain themselves well? Are they good listeners? As one director suggested, it is important that a new director be "somebody who is a good listener and has the patience to hear somebody else out." Although one would expect communication skills to go along with valuable work experience, it isn't always the case. As one experienced director explained, "You can be the smartest person, but if you don't speak out frankly, it's worthless. You've got to be effective in communicating, in a way that people will listen to and not just turn off."

The *personality of new directors* is an additional important consideration. Sitting directors should evaluate whether the new director "clicks" with the board and has the right attitude, the integrity to represent shareholders effectively, and the courage to speak up to the CEO and management. Indeed, one of our directors commented that boards should choose directors that are "very optimistic and positive but not afraid to ask serious questions" and "forceful and outspoken, and not at all hesitant to voice their point of view on any subject." As one experienced director summarized, "There is nothing worse than a board member who comes in and sits there and doesn't say anything." Stanley Gault of Rubbermaid told us what he says when invited on a board: "I will do my homework, and I will learn as much about the business as possible, but I do speak my mind. If you're looking for someone who will always agree with management and be a 'rubber stamp' director, I'm not your boy.'"

Finally, board members noted that potential directors must have the *time to serve*. With the average executive now sitting on four boards, almost a quarter of the companies in the Korn/Ferry International survey (2001) actually place limits on the number of other board seats their directors can take on. Without adequate time, directors will be unlikely to attend all board meetings or be as involved in decision-making as they might otherwise be, limiting their ability to contribute to constructive debate, decision comprehensiveness, and team dynamics on the board.

Structure: Put a Meaningful Structure in Place

A board's structure is also an important element in promoting effective process. It is becoming fairly common today for boards to appoint an executive committee that meets more often than the full board and has responsibility for certain decisions. While this practice has potential advantages (speed of decision-making, for example), it can also create a two-tier system that elevates the executive committee to a higher authority. Over time, the other directors might start to see themselves as less central. Such tension can lead to destructive conflict and make it harder for the board as a whole to work together. So, boards should *assess their committee structure to ensure that it does not result in unnecessary divisions among directors.*

The directors we interviewed also suggested that *a structure be put in place to help directors communicate between board meetings.* Whether the entire board meets via conference call between formal board meetings, or individual directors initiate their own calls to the CEO, ongoing communication is critical. For example, one director said, "If I see something in the paper or I'm curious about a competitor, I'll often call him [the CEO] and chat with him about it, what's going on with this guy—and how about this (some strategic, M&A thing that is going on with one of the competitors), have they moved into another business or discontinued a business, things like that." By leaving the door open for communication beyond the small number of board meetings held each year, directors can do a better job of monitoring management, and managers will have more timely feedback from outsiders.

Appointing an outside lead director can help improve board functioning. An outside lead director who is truly independent of the CEO could help mitigate a CEO's control by being more involved in planning the board agenda and facilitating board meetings so that the right strategic issues are considered and critically evaluated. As Josh Weston of ADP explained, this might not mean appointing one lead director; boards can have multiple lead directors that lead based on their areas of expertise. He says:

> I am on the JCREW board. Stuff with JCREW, I'll get very involved in at the board meeting. But then when they get into style discussions, I know enough to know that there are a lot of people there that know more. In other words, I'm not the lead director in that dialogue. They have the guy who is the CEO of Federated Stores; he knows more about it than I do. It isn't the same person all the time; I don't think it should be.

Another important practice that should be built into the structure of the board is to *regularly evaluate the board and CEO using clear performance metrics.* Stanley Gault provides this blueprint:

> This evaluation process should be managed by an outside independent organization, and every committee of the board should undergo an annual evaluation of its performance. . . . If the performance or conduct of any board member(s) is deemed to be . . . of concern to the other members, the chairman and at least one other board member should arrange to meet with the involved individual(s) to dis-

> cuss the issues or concerns that have been identified and how the individual(s) proposes to address them. If the issues are not resolved satisfactorily in a reasonable time, the individual(s) should resign from the board or the board should not recommend the individual(s) to stand for re-election as a board member.

Finally, boards should *set term limits to keep the board fresh*. Directors that serve together for years on end may be less inclined to question management critically. As one director put it, directors can get "pretty tight with management" over time. Directors who serve for a long period of time might also not have the right expertise to comprehensively address the firm's current strategic issues. As D.R. Grimes explained, "If you are a director of a company and the biggest company you ever worked for is X and then all of a sudden the company you are a director for grows from X to 10X—that may be a challenge."

Staging: Set the Stage for Effective Board Meetings

Once the right directors have been selected and a meaningful structure is put in place, directors need to set the stage for effective board meetings. In particular, the directors we interviewed repeatedly noted how important it was that boards *establish criteria for the strategic decisions which the board will address.*

How can directors assess what is appropriate? Russell Lewis, CEO of the New York Times, put it bluntly: "The board's primary responsibility is to make sure the management team knows what the hell it's doing." The CEO of a major fashion company said, "I think the board should approve the strategies of the company—I don't mean that in any passive reactive way—it should be engaged in the process, and I think it ought to hold the CEO and the management accountable for results."

"The board's primary responsibility is to make sure the management team knows what the hell it's doing."

In addition to overseeing strategy, the other areas directors agreed were non-negotiable were performance shortfalls and CEO succession. As one experienced director put it, "The most important role a board has is naming the chief executive officer, and that is wholly and solely the board's function, prerogative, and responsibility to shareholders." Several directors emphasized that the extent of board involvement on an issue depends on its potential downside. The director of a global media services company said, "Boards really come into their own in fearful situations. Number one, when there is a change in chief executive and somebody has got to make that call is when the board really has to be tested, and second, when you want to merge, buy, or be bought, and third, when you decide to expand either in a big way into a new geography, a new category, or a completely new business."[18]

The upshot is this: boards must decide what triggers will force a closer look at the CEO and his or her activities. Whether it involves the board agreeing on a particular investment threshold that automatically triggers the board's attention, as one director told us, or some other method, the right time to have this debate is before something goes wrong. Setting decision criteria helps boards be more comprehensive when they need to be, while reducing the likelihood that any director will be an "internal busybody."

Agreeing to the triggers for comprehensive action is not the only prep work for boards. Directors need to *clarify expectations and rules of behavior* for such matters as attendance at board meetings, confidentiality of discussions, and involvement in discussions. These rules will help directors understand and, in turn, meet the expectations of their fellow directors, promote collective action,[19] and aid new directors in getting up to speed more quickly.

Directors should also consider what other steps can be taken to *help new directors get assimilated on board*. How many companies spend the time to ease the passage of a new director into an already established group? How often are specialized orientation programs created to help a new director gain not only a deeper understanding of the company's direction but also insight into board functioning and dynamics? For example, one director noted that the CEO of the company flew to see her and spent half a day discussing the firm's financials. In another case, a director mentioned that a couple of senior directors sat down with him separately for a few hours before the first board meeting to give him a sense of what to expect. But overall there were few such testimonials; many of our directors agreed that when they were starting out on their boards, they could have benefited from more help from standing directors.

Adequately preparing for board meetings also sets the stage for stronger interactions. As Bob Galvin of Motorola said, "My advice would be to learn as much about the company as you can so that you are relevant, and then give unto us every bit of common sense that you can, and that will be your value added as a member of the board."

Of course, directors' busy schedules get in the way of finding the time to prepare. And directors were quick to tell us how frustrating it was to receive discussion materials just before the meeting, without adequate time to review them. Thus, directors should *demand adequate time to prepare for meetings*.

Time is one thing, but quality of materials is another. As one director put it, "Information packets which directors receive should have sufficient detail to make them useful, and directors should request additional information if needed." If the materials are not adequate, directors should speak up to *ensure that the materials they receive are meaningful*. One director, for example, said that he has often called to request clarification of an agenda item or to request additional readings on an issue before the board meeting.

Preparation can only go so far when board meetings are as jam-packed as directors insisted they are. Directors must work with the Chair to *ensure that meetings are not overscheduled and that time is left for directors to discuss issues and become familiar with one another*. Not only would this allow directors greater opportunity to process the information they are hearing, but having more time to interact would also help cut down on destructive conflict. As a director of a major Fortune 500 company said, "The better you get to know and understand about other people on the board, to develop chemistry, the more effective you'll be as a total board."

Given the time constraints of board meetings, directors should look for other opportunities to learn more about the CEO and management as well as the company as a whole. One way is to *periodically hold meetings "in the field,"* as Home Depot does with board members visiting dozens of stores a year. One of our board members stressed how helpful such a practice can be: "Have board meetings in manufacturing plants, in sales offices, in distribution centers . . . any place but the boardroom, to be in contact with the real world as opposed to the ivory tower, which everybody has a tendency to be corrupted by when you sit in those rooms."

Steering: Steer Board Meetings to Improve Board Process

It is during board meetings that much of the work of boards is accomplished, and it is here that the processes of group interaction play out in such a substantive way. Consistent with their key roles, directors must *keep a close eye on management and have the "guts" to disagree with them*. As Charles Elson, the Sunbeam director, put it, do you "have the stomach to make difficult decisions for the shareholders' benefit? If the answer is no, you shouldn't be on a board." The need for courage is even more important when the CEO is especially powerful or dominant.[20]

The best time to challenge a CEO, however, is not when the only option is dismissal. Before that happens there are always a series of actions, or inactions, to which boards are privy. Several directors who were also CEOs acknowledged that their boards often disagreed with them. Robert Galvin of Motorola relayed this experience: "I proposed two acquisitions that I felt were very significant. The board voted me down. We walked out of that board meeting, and you would never have known there had been a negative meeting . . . that's what they are there for. They voted their point of view. It was different from mine."

Despite the importance which directors attributed to having boards with the "guts" to disagree with management, they almost uniformly acknowledged that more is needed. And one of the biggest areas where directors find themselves at a disadvantage relative to the CEO is their knowledge of the company. Outside directors can never truly understand a company's business in the way that insiders do, but this gap is wider than it need be in many firms. Many of the directors we interviewed tackled this challenge by recommending that boards *talk to the people who are directly involved in decisions*. A director of a food products company said that consulting individuals in the firm or even people outside the firm like suppliers or customers can enrich the board's decision-making. He said, "We are given access to those who have come up with and done the work, which I think is superior because it's not filtered."

In a similar vein, it is increasingly common for boards to *solicit help from outside experts to enrich decision-making*. Aviall's Paul Fulchino, for example, regularly brings in experts to help boards understand a decision they need to vote on. Fulchino also makes it a practice to invite consultants about once a year to help his board understand and contribute to Aviall's strategic plan.[21] Other boards expect to hear from lawyers and investment bankers, when needed.

Even informed directors can face resistance from recalcitrant CEOs. One idea that kept coming up in the interviews that can help in this regard was to dedicate some time for directors to *meet without* *the CEO*. Josh Weston of ADP pointed out how convening in executive session without the CEO present is particularly helpful in dealing with powerful CEOs because directors get an opportunity to freely voice concerns about the CEO's performance, or anything else. In fact, Weston insists that each board he joins has an executive session on every agenda. Institutionalizing executive sessions means "you don't have to furtively run through the halls or set up secret conference calls." Veteran director Dave Wathen agreed. He told us, "Sometimes the board might have completely separate ideas about the strategy of the company and at least be able to bounce those around without threatening the management. A process where the board meets separately would help that. I've been a CEO, and it's a great job, but it always feels high risk. It's not fair to cause a CEO undue anxiety."

Another approach to encouraging constructive conflict, addressing decisions comprehensively, and avoiding groupthink[22] is to *promote devil's advocacy on the board*. According to Charles Elson, "Devil's advocates are terrific in any situation because they help you figure a decision's numerous implications . . . the better you think out the implications prior to making the decision, the better the decision ultimately turns out to be. That's why a devil's advocate is always a great person, irritating sometimes, but a great person."

Best practices for board process also include directors taking upon themselves the task of *soliciting feedback from more junior, and less vocal, directors*. Dave Wathen argued that "every one of us [board members] has a responsibility to help fix that problem of deferring to high-status people on the board and purposely turn to Bob and say, 'You haven't talked much. What do you think about this?' You've just got to do it once in a while." For example, the consumer products CEO we interviewed said that he makes it a point to solicit feedback from quieter board members. In fact, he noted that in some circumstances, he might even call or have lunch with such board members so that he can talk to them individually. Such initiatives might push junior and quieter directors to speak up and help these directors feel more a part of the board, improving the board's chemistry and ability to act as a team.

Even senior directors can get shut out of a debate when "airtime" is constricted in tightly choreographed board meetings. If we really believe that boards are groups, however, there are well-established methods to address this problem. But it starts with directors who *encourage facilitation techniques that can promote greater director involvement and debate*. A director of several Fortune 500 companies said,

> If there is a good CEO, they have the unique power and ability to facilitate an extremely effective board by good communications, by chemistry . . . by candor and openness, and that can't be stressed enough. What does 'an ability to facilitate' look like? To encourage participation, to draw out the best in people, to not allow a prominent personality to be the only voice that everybody hears, to establish the climate where you feel comfortable to express an opinion.

Facilitation techniques abound. It could be as simple as asking each director to comment on major issues or employing more sophisticated methods such as the nominal group technique,[23] dialectical inquiry,[24] or the Delphi method,[25] all of which are designed to improve the richness of discussions and reduce the opportunity for one or two people to dominate.

To make the most of board meetings, directors should also take time out to *regularly ask CEOs probing, big-picture questions*. For example, in each board meeting, directors might ask the CEO to identify the top three issues the company is focused on, or the top three things that could go wrong and what the company is doing about them. Provided the CEO is candid in his response, this will allow the board to understand the big picture as the CEO views it. And experienced directors, particularly those that are CEOs themselves, will often be able to see through presentations that only skate over the critical issues. In either event, the process should also provide boards some direction for key areas to monitor management.

Either by asking such questions or just through the ordinary course of board meetings, directors should be actively involved in *scenario planning* to prepare for major events that are potentially "life changing" for the corporation, such as merger, bankruptcy, or fundamental competitive or regulatory change. One long-time board member said that it isn't enough for the board to passively await an unknown fate. The board "should prepare ahead of time. Expect the worst and prepare."

That is an appropriate way to end our discussion of best-practice recommendations for excellent board process. When we recognize that boards are really groups, and that much of what we know about groups can be translated to boards of directors, a new window opens up to making boards work. As our interviews indicate, process really does matter.

Focus on Board Process

Academic research is sometimes criticized for being out of touch with what is happening in the real world, but for work on corporate governance, this critique doesn't hold. Both academicians and corporate governance experts have been drawing from the same playbook for some time; yet the irony is that the book may be wrong. While the goal of board independence is still a fundamental one, the dominant approach to achieving that goal needs to go beyond the "usual suspects" and embrace a more complex but realistic perspective. Simple demographic solutions to corporate governance problems have hit the point of diminishing returns—boards are more "independent" according to the classic indicators than at any time since people have kept track of such things; yet corporate governance breakdowns seem to be appearing more often than ever.

In this paper we emphasized three points: (1) reliance on the "usual suspects" to assess board independence or to improve board effectiveness is flawed; (2) a messier and more complex, but in the end more valuable, approach to understanding boards is to focus on the key attributes of board process; (3) each of the attributes of board process is a potential lever that directors and CEOs can use to improve the practice of corporate governance in their companies.

Based on our analysis, it seems clear that board process likely has a very real and important impact on overall board effectiveness and even firm performance. Board members readily acknowledge the centrality of process when asked how boards really operate. They see process issues as central not just to how they function as a group but to their ability to act independently of the CEO. In this view, board independence is less an objective set of indicators based on composition and structure and more a function of how board members themselves can effectively operate as a group to fulfill their roles. This study, by bringing together the academic literature and qualitative data from interviews with 32 directors, is an important step in our evolving understanding of how boards work, and how they can be made to work better.

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Endnotes

[1] Research on board independence is truly voluminous. One of the first in-depth studies of what boards of directors actually do appears in Mace, M. L. 1971. *Directors: Myth and reality.* Boston, MA: Harvard University Press. A good summary of much of the academic literature on board independence can be found in Chapter 7 of Finkelstein, S., & Hambrick, D. C. 1996. *Strategic leadership: Top executives and their effects on organizations* (in West's Strategic Management Series). Minneapolis, MN: West.

[2] The importance of outsiders on boards has been stressed by much work in corporate governance. For an overview of that research, see Dalton, D. R., et al. 1998. Meta-analytic reviews of board composition, leadership structure, and financial performance. *Strategic Management Journal,* 19(3): 269–290. Other work includes Fama, E. F., & Jensen, M. C. 1983. Separation of ownership and control. *Journal of Law and Economics,* 26(2): 301–325 (stressed the greater objectivity of outsiders); Walsh, J. P., & Seward, J. K. 1990. On the efficiency of internal and external corporate control mechanisms. *Academy of Management Review,* 15(3): 421–58 (focused on the reputation effect of directorships); and Boeker, W. 1992. Power and managerial dismissal: Scapegoating at the top. *Administrative Science Quarterly,* 27(3): 538–47 (studied the relationship between outsiders and CEO dismissals).

[3] For examples of work dealing with director shareholdings, see Alchian, A. A., & Demetz, H. 1972. Production, information costs and economic organization. *American Economic Review,* 62(4): 777–95; and Zahra, A., & Stanton, W. 1998. The implications of board of directors' composition for corporate strategy and performance. *International Journal of Management,* 5(2): 229–236.

[4] For examples of work on board size, see Zahra & Stanton, op. cit. A review is also included in Dalton, et al., op. cit.

[5] For research on CEO duality, see Biggs, J. 1995. Why TIAA-CREF is active in corporate governance. *The Participant,* p. 2; Monks, R., & Minow, N. (Eds.). 1995. *Corporate governance.* Cambridge, MA: Blackwell Business; and Finkelstein, S., & D'Aveni, R. A. 1994. CEO duality as a double-edged sword: How boards of directors balance entrenchment avoidance and unity of command. *Academy of Management Journal,* 37(5): 1079–1108.

[6] Johnson, J. L., Daily, C. M., & Ellstrand, A. E. 1996. Board of directors: A review and research agenda. *Journal of Management,* 22(1): 409–438.

[7] Where interviewees gave us permission, we include their names and titles to provide context for what they told us.

[8] Arguments against stock ownership can be found in Daily, C. M., Certo, S. T., & Dalton, D. R. 1999. Pay directors in stock? No.: It's supposed to align them with stockholder interests, but it's an idea full of traps and snares. *Across the Board,* 10(6): 47–50; and Grossman, W., & Hoskisson, R. E. 1998. CEO pay at the crossroads of Wall Street and Main: Toward the strategic design of executive compensation. *The Academy of Management Executive,* 12(1): 43–57.

[9] See Dalton, et al., op. cit., and Finkelstein & D'Aveni, op. cit.

[10] Additional support for this assertion comes from Dalton, et al., op. cit.

[11] For emerging research on board process, see Forbes, D. P., & Milliken, F. J. 1999. Cognition and corporate governance: Understanding boards of directors as strategic decision-making groups. *Academy of Management Review,* 24(3): 489–505; Monks & Minow, op. cit.: Charan, R. 1998. *Boards at work: How corporate boards create competitive advantage.* San Francisco:

Jossey-Bass; and Sonnenfeld, J. What makes great boards great. *Harvard Business Review,* 80(9): 106–113.

[12] Constructive conflict, also commonly referred to as "task" or "cognitive" conflict, has been found to be beneficial for decision-making in top management teams (see Amason, A. C. 1996. Distinguishing the effects of functional and dysfunctional conflict on strategic decision-making: Resolving a paradox for top management teams. *Academy of Management Journal,* 39(1): 123–148) as well as work groups (see Jehn, K. A. 1995. A multimethod examination of the benefits and detriments of intragroup conflict. *Administrative Science Quarterly,* 40(2): 256–283). Its benefits stem from exchanging and blending multiple perspectives, as shown by Schweiger, D. M., Sanberg, W. R., & Rechner, P. L. 1989. Experiential effects of dialectical inquiry, devil's advocacy, and consensus approaches to strategic decision-making. *Academy of Management Journal,* 32(4): 745–772.

[13] Destructive conflict, also commonly referred to as "emotional," "interpersonal," or "affective" conflict, was studied along with constructive conflict in studies by Amason, op. cit., and Jehn, op. cit., and found to have damaging effects on team decision-making.

[14] The importance of working together in a team has been stressed in the top management team literature. For examples, see Hambrick, D. C. 1994. Top management groups: A conceptual integration and reconsideration of the 'team' label. In *Research in organizational behavior,* Staw, B. M., & Cummings, L. L. (Eds.). Greenwich, CT: JAI Press: 171–214; Hambrick, D. C. 1998. Corporate coherence and the top management team. In Hambrick, D. C., Nadler, D. A., & Tushman, M. L. (Eds.). Navigating change: How CEOs, top teams, and boards steer transformation. Boston, MA: Harvard Business School Press: 123–140; and Siegel, P. A., & Hambrick, D. C. 1996. Business strategy and the social psychology of top management teams. In Shrivastava, P., Huff, A., & Dutton, J. (Eds.). *Advances in strategic management 3.* Greenwich, CT: JAI Press: 91–119.

[15] Staw, B. M., Sandelands, L. E., & Dutton, J. E. 1981. Threat-rigidity effects in organizational behavior: A multi-level analysis. *Administrative Science Quarterly,* 26(4): 501–24.

[16] For research dealing with addressing decision comprehensively, see Fredrickson, J., & Mitchell, T. 1984. Strategic decision processes: Comprehensiveness and performance in an industry with an unstable environment. *Academy of Management Journal,* 27(2): 399–423; and Fredrickson, J. 1985. Effects of decision motive and organizational performance level on strategic decision processes. *Academy of Management Journal,* 28(4): 821–843.

[17] For examples of research emphasizing CEO influence in director selection, see Anderson, C. A., & Anthony, R. N. 1986. The new corporate directors: Insights for board members and executives. New York: Wiley; and Lorsch, J. 1989. *Pawns or potentates: The reality of America's boards.* Boston: Harvard Business School Press.

[18] It is in these "fearful situations" that outsiders may actually play their biggest role. Consistent with what some of our interviewees told us, board independence may matter most when a company is dealing with a takeover or other stressful event. See Chatterjee, S., & Harrison, J. 2001. Corporate governance. In Hitt, M., Freeman, E., & Harrison, J. (Eds.). *Handbook of business strategy.* London: Blackwell: 543–563.

[19] See Katzenbach, J. R., & Smith, D. *The wisdom of teams.* New York: Harper Perennial.

[20] A remarkable number of the CEOs at the helm of scandal-plagued companies were towering figures that faced little internal opposition from other managers or the board of directors. Some attributes of companies that fall into this trap, and the way certain leadership habits give rise to such out-of-control CEOs, are described in Finkelstein, S. 2003. *Why smart executives fail.* New York: Portfolio.

[21] These efforts to expand the sources of relevant information that boards can tap into is very much in line with what experts in group decision-making advocate—groups that only discuss issues among themselves can become insular and more susceptible to limited decision-making and groupthink. See Janis, I. L. 1972. *Victims of groupthink: A psychological study of foreign policy decisions and fiascos.* Boston: Houghton Mifflin.

[22] Irving Janis identified groupthink in 1972 (see Janis, op. cit.). Although he did not use the term "devil's advocate," in a later book (Janis, I. L. 1982. *Groupthink: Psychological studies of foreign policy decisions and fiascoes.* Boston: Houghton Mifflin), Janis stressed that to avoid groupthink, groups should assign "critical evaluators" to assess decisions made and generate other alternatives.

[23] The Nominal Group Technique (NGT) systematically assesses group members' opinions about key issues. For information about the technique, see Gustafson, D. H., et al. 1973. A comparative study of differences in subjective likelihood estimates made by individuals, interacting groups, Delphi groups, and nominal groups. *Organizational Behavior and Human Performance,* 9(1), 280–291.

[24] For more information, see Schweiger, D. M., Sanberg, W. R., & Rechner, P. L. 1989. Experiential effects of dialectical inquiry, devil's advocacy, and consensus approaches to strategic decision-making. *Academy of Management Journal,* 32(4): 745–772.

[25] The Delphi Method is a method of improving group decisions using the opinions of experts. For more information about the technique, see Dalky, N. 1969. *The Delphi Method: An experiential study of group decisions.* Santa Monica, CA: Rand Corporation.

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