A PRACTICAL PERSPECTIVE:

THE FOUR PILLARS OF BOARD EFFECTIVENESS

Corporate events in the last decade have made it clear that boards can fail. Failure has come in various disguises: failure to manage risks, to proactively contribute to firm strategy, to identify the 'right' team, and in some cases, to deal with integrity issues and possibly outright fraud. It is also clear that we need better governance at all levels. The latter calls for increasing board effectiveness. In this article, we aim at distilling the different factors that contribute to board effectiveness. We locate those factors in four pillars.

BY PROF. DR. DIDIER COSSIN AND IMD RESEARCH FELLOW JOSE CABALLERO

The first pillar is people and builds on their quality, focus and dedication.

Boards could be composed by high-quality individuals, who are outstanding in their respective fields; for example, CEOs, academics, government officials, etc. And yet, they could lack the necessary knowledge to perform their tasks as members of a specific board. The case of JP Morgan's 2012 loss and its use of a complex trading system (the credit default swap CDX.NA.IG.9 index) illustrate this point. JP Morgan incurred a loss of several billions of dollars as it overlooked the warnings about the risks involved in the trading system. It later emerged that none of the three directors on the board's risk-policy committee had worked as a banker or had any experience in Wall Street in the past 25 years, and that one of them was a museum director (it is also interesting to note that in 2012, in the midst of the unsuccessful attempt to purchase assets from Lloyds Banking Group, it came to light that the Cooperative Banking Group's board lacked adequate banking expertise; for example, the board included a plasterer and a nurse). This case clearly underlines the significance of the quality of board committees: members of the different committees are expected to have the necessary and relevant knowledge. Otherwise, limited knowledge affects their ability to perform their functions effectively. To overcome this problem, effective boards establish performance and knowledge standards for individual directors, they educate their board members, and they conduct evaluation along those standards. The quality of the board is enhanced by diversity in terms of industry and professional background, as well as diversity of gender, personality and opinion. Diversity brings specific expertise as well as more potential for

innovation. Poorly managed diversity, however, can be disruptive as communication may become more difficult and trust may be lesser amongst more diverse directors. A strong board will thus develop processes to manage diversity well. We recommend for boards to have a systematic board composition oversight, with regular assessment of capabilities required (from expertise to familiarity) and a current composition matrix, even for well established boards.

More often lacking than skills themselves, the director's area of focus and dedication to the firm's activities are both essential. Focus could be diminished by directors misunderstanding of their roles and functions within the board. To reinforce their focus, boards establish their own statement of purpose and define their role in a manner that adds value to firm activities. Boards need to regularly reflect on their involvement and strive for it to be first, distinctive, in a sense that does not replicate efforts from other quarters in the organization; and second, additive, for example, that improves decisions made by the firm. Dealing with ambiguities in decision-making is inevitable and is a sign that the board addresses real issues. Well-focused boards distinguish the adequate context in which to perform a supervisory role and in which to offer support to management. Such boards are quick to determine when a proactive risk oversight is needed but they are also efficient in identifying, and in acting on, the need to communicate the firm's strategic objectives in order to manage its reputation during a crisis. Additionally, the focus of the board is strengthened by a successful agenda; one that is turned towards the future more than the past and whose aim is to capture long-term issues while managing short-term matters.

Dedication to the firm is also an important aspect of this pillar. Dedication goes beyond the allotted meeting time. It implicates, for example, the reasons why an individual decides to become a director. Incentives differ; there is potential for access to networks, access to industry-specific information and an elevated status to determine an individual's decision to join a board. Such incentives would negatively impact his or her dedication. On the other hand, there are cases in which individuals become board members because they are highly motivated to make the firm successful. Such is the case of Mr. Anthony Leung. Mr. Leung joined the board of the Industrial and Commercial Bank of China(ICBC) with a firm objective: to make a Chinese bank one of the most successful banks in the world. And in practice, Mr Leung strove to achieve that objective. Although, he lived in Hong Kong, his dedication led Mr. Leung to obtain an apartment in Beijing so as to have ready access to the bank. He then went on to challenge the chairman on his strategy, to challenge the risk reporting of the bank, taking apart what was brought to him and proposing examples of better methodologies, both at board levels and in one to one meetings with management. The quality of the directors, their focus and dedication is thus our first pillar of truly effective boards.

> "DEALING WITH AMBIGUITIES IN DECISION-MAKING IS INEVITABLE AND IS A SIGN THAT THE BOARD ADDRESSES REAL ISSUES"

A typical checklist for self assessment on the first pillar could include the following questions:

1. How close to the heart of every board member is this company?
2. Where do I truly add value to this board?
3. How confident am I in my board colleagues to steer our company the right direction?
4. How is our diversity in terms of abilities, personalities, competencies?
5. How clear are we about the role of our board? The role of each committee?
6. Is the agenda turned enough towards the future?
7. How does my knowledge compare to the one of the ideal board member on this company?

Information architecture is the basis of the second pillar of effectiveness.

Information is best when it is designed in a way that informs the board about all the essential activities undertaken by the company and the issues facing it. When thinking of information design, boards typically think of information coming from management (how brief, well focused and strategic it is, prioritized, with executive summaries, key issues to tackle and options to consider). But information architecture should include also external information (what can we source from outside the company, such as from social media). It should also include formal information and informal information sources (such as informal networks: the ability of the chairman of Singapore Airlines to maintain good relationships with union representatives is an important source of information for the company).

For the formal internal information, jointly designed board briefings that include financials with forecasts, a CEO report, risks and opportunity maps, analysis of the genepool and summary of financial analysts' views contributes to the quality of the information architecture. Additionally, regular communication between management and the board, for example management letters in between meetings adds to efficient information. Committee reports are also fundamental in fomenting the effective architecture of information. Adequate reports, nevertheless, encompass analysis of specific issues rather than just recommendations. A key checkmark is whether the board is actively involved in designing the information and whether that information design changes with the firm, its environment and its strategy.

"SOPHISTICATED INFORMATION ARCHITECTURE IS KEY TO SUCCESSFUL BOARDS"

Informal channels of information are key as well and should be well elaborated themselves; for example meetings with employees and informal meetings of board members, all need both structuring, to give them potential, and some freedom, to give them creativity without infringing on management's rights. In short, sophisticated (but not necessarily complex) information architecture is key to successful boards.

Here is a first checklist to reflect on the information pillar:
1. Do I know and track intimately business and its key value drivers?
2. Am I well informed of competitive trends, regulatory changes, technological changes, stakeholder evolution?
3. Do I have enough information independent from management available for my judgment?
4. What informal processes of information do I have?
5. How involved was I in designing the information architecture? How involved were my fellow board members?

Structures and processes constitute our third pillar.

In terms of structures, the composition of the board contributes to effectiveness. Structures are evolving greatly as governance become more sophisticated. As mentioned previously, well-managed board diversity of opinion, experience, personality and genre greatly impact effectiveness. The independence of board members is also crucial. But so is their structured access to the right individuals. For example, in some organization, the chief risk officer has a dotted reporting line to the chairman of the risk committee, or to the chairman of the board. In addition, the effective function and the necessary number of board committees are to be taken into account as is the size of the board. It is, in short, fundamental for the board to regularly benchmark its current composition and structures against the ideal situation and to act on any divergence. Innovative examples include HSBC's committees on Financial System Vulnerabilities and Conduct & Values, that tackle two primary strategic goals in the new world of banking.

"GOOD PROCESSES WILL ENRICH THE THREE DIMENSIONS"

In terms of processes, there are many processes beyond the straight running of the board: evaluation processes, the strategy process, the risk process, the board education process, the CEO and key managers succession processes, the regulatory process, etc. For example, the board strategy process plays a significant role in increasing effectiveness. The board strategic involvement occurs along three dimensions: co-creation, supervision and support (for more details, see our article How Strategic Is Your Board?). Good processes will enrich the three dimensions. Typically, regular meetings will complement retreats. External presentations will complete internal ones. And focused, decision-oriented meetings will complement long term understanding of the industry and business from a strategic perspective. And such process elaborates on various aspects. It strengthens firm strategy by contributing to define it, aligning it with objectives and ensuring commitment. The process also enhances the strategic reflexion of the board and reinforces the interactions between management and board. The process creates a stronger basis for communicating the company's strategy, internally and externally. A well designed strategy process ultimately enables boards to efficiently assess the company's strategic risks as well as its strategic opportunities. Another decisive process is that of board evaluation. A poor evaluation process contributes to governance failure; therefore, thriving boards engage inself-assessment or external assessment, in terms of their roles, dynamics and their members' performance. A good practice is to utilize available technology, for example the use of tablets, for board evaluation during meetings which provides results in 'real-time' and thus offers an opportunity for careful and dynamic scrutiny beyond the one-year evaluations. CEO succession is also a critical process.

A successful succession planning, whether based on 'horse race' or search, internal or external, aims at the transparency of selection, the quality of the on-boarding process and the smoothness of the transition. A case in point is that of Hewlett-Packard (HP). In a period of six years, HP fired three CEOs, a trend that became a corporate turmoil which negatively affected the company's brand reputation. Relevant to our discussion, is the fact that in one of the cases the HP board did not meet the new CEO before nomination, and also the implied failure of the board at identifying a candidate that would fulfil the strategic vision of the company.

Here is a self assessment checklist on our pillar of structures and processes:
1. What is the list of processes that truly matter?
    a) strategy,
    b) evaluation,
    c) CEO succession,
    d) risk,
    e) board education,
    f) audit,
    g) regulatory compliance
    h) onboarding/outboarding
    i) others?
2. How do I feel about each of these processes? Do I have a clear view of each? Is each complete and detailed enough?
3. Do we have the right committees? The right people on them?

4. Are the reporting lines fool proof?

The final pillar of effectiveness is that of group dynamics.

Dynamics are fundamentally linked to the culture of the board. In this aspect, it is necessary to consider board pathologies. Group-think tendencies, for example, hinder effectiveness as do disruptive or dominating members of the board. A low energy level on the board, the sleepy board, is also typical. In some cases, dysfunctional dynamics are openly employed to set aboard up for governance failure. Late distribution of information and not making relevant information available are examples of intentional practices that hinder governance. This is often a symptom of a deeper issue: lack of trust, role overlap, etc. Governance is enriched by the directors' differences in opinions and constructive dissent: having a critical view of assumptions makes for an effective strategy. And yet, despite the importance of these elements, some firms appoint directors who are close associates of the company founder or its CEO. The appointed individuals may be prominent in their respective industries but their practices within the board are circumscribed by their relationship with a dominant figure of the company. A case is point is that of a leading designer of consumer electronics, computer software and personal computers (Apple). The board was constituted by outstanding professional figures but with close relationships with the founder of the company. As such, the board was destined for ineffectiveness as it ran the risk of sharing common views and heuristics which could threaten true dynamics, such as constructive dissent, that could safeguard its governance culture. The love board, in which the CEO can do no bad, is certainly a failing board.

Interactions between board and senior management are an important aspect of the dynamics pillar. The experiences of Yahoo! highlight the disruptiveness, if not

destructiveness, of strategic disagreements between the CEO and the company board. Former Yahoo! CEO Carol Bartz's complaints about the lack of strategic coherence between management and the board, illustrate the point. In the end, Ms Bartz was dismissed by phone, which is not a sign of good chairman-to-CEO dynamics! It is noteworthy to point out that Yahoo has had six CEOs during the 2007-2014 period. Effectiveness is enhanced when such rivalries and disputes are minimized while discussions remain rich and challenging. This can only be achieved by a board that makes its rule of engagement clear to all its members, that promotes the equal participation of its members and their mutual respect. Functional board dynamics can also contribute to hindering conflict of interests. A board culture that emphasizes accountability towards the pertinent stake holders and that it is based on openness and constructive dissent adds to the minimization of such conflicts. It also diminishes the possibilities of directors' over-confidence: functional board dynamics ensure that board members are connected to reality. The chairman's role is key in developing a successful board culture. And an effective culture can be partly formalized in writing so as to be easily shared and understood. Awareness of discussion styles (fast thinking, influencing, false yes, etc.) and decision styles (autocratic, consensual, indecisive, etc.) are key to evolve group dynamics.

Board effectiveness comes about by ensuring that the pillars discussed in this article are constantly sustained; that is to say, boards thrive by building their governance culture on these pillars. Boards cannot neglect the quality, focus and dedication of its members. Information architecture needs to be carefully designed in order to optimize its value toward effectiveness. Similarly, the quality of board structures and processes is essential for its effectiveness. Successful boards continuously improve their work processes as they become more sophisticated than in the past. Finally, board dynamics based on a culture that promotes quality discussion, greatly contributes to the strategic coherence of the firm and in doing so reflect the effectiveness of the board. Excellence in the aforementioned pillars makes, indeed, for sustainable success in board practices.

"AWARENESS OF DISCUSSION STYLES AND DECISION STYLES ARE KEY TO EVOLVE GROUP DYNAMICS"

A preliminary checklist on this last dimension can include these self assessment questions:

1. How energetic is my board?
2. How do I feel about the contribution of the different board members? Why?
3. Does the culture of my board provide for well-managed meetings and 'equal participation' in discussions?
4. Do I really listen to the opinions of others? Do I challenge others, respectfully but without conceding, while keeping the relationship personal?
5. Are my contributions short and to the point? Do I make them when I have knowledge or judgement?
6. Should I talk to the chairman about something that we do not address well, possibly even his own role?

Boards keep fine-tuning themselves towards better effectiveness. Our four pillars methodology is a proven methodology that we have used to help support many boards transform towards higher success. Society's expectation is that governance can be improved. A systematic and continuous improvement along these four pillars is a strong asset for any organization.

ABOUT THE AUTHOR

Professor Cossin is the director of IMD Global Board Center. He works with senior leaders, executive committees and boards to provide the latest thinking on best-in-class governance, risk and opportunity optimization, investment selection and strategy design.

He favors an adaptive and interactive approach to finding distinctive solutions for organizations on a wide range of management topics. His latest research focuses on the role of the board in achieving success. His past research has dealt with risks, M&As and financial decision making.

In his work with boards, Professor Cossin helps them enhance organizational performance through strategy involvement, best-in-class decision making, information management and general governance (including board restructurings).

He is an advocate of adapting board work to the economic transformation taking place in many regions of the globe, and through his international experience he has gained insights into the different ways in which societies and economies deal with the issues at stake. He also looks at the latest approaches to risk issues. His work addresses not only technical risks (for which he uses his finance background) but also those arising from a number of different factors: psychological biases, social and cultural environments, technological changes (such as in information issues), strategic choices and/or from governance structure (for which he levers his long experience with senior leaders).

Professor Cossin is an advisor and/or executive teacher with the United Nations, central banks of several countries, the boards or executive committees of corporations, financial institutions and funds in Europe, Asia and the Middle East.

His most significant experience is with the oil and gas industry (Schlumberger, Shell, Sinopec, Saudi Aramco and others) and the banking industry (HSBC, Bank of America, Goldman Sachs, ICBC and others), but he has also worked with many other industries (media, luxury goods, retail, shipping, etc.). He is a member of the Risk Who's Who Society, the American Finance Association, the Eastern Finance Association, and the European Finance Association.

**PROFESSOR
DIDIER COSSIN**

SWISS AND FRENCH

PROFESSOR OF FINANCE
AND GOVERNANCE

DIRECTOR OF THE
IMD BOARD CENTER

PHD IN BUSINESS
ECONOMICS
HARVARD UNIVERSITY

IMD | IGBC IMD GLOBAL BOARD CENTER

Contact us

Quentin Dufresne
IMD Global Board Center
Tel: +41 21 618 02 65
www.imd.org/boardcenter
boardcenter@imd.org

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