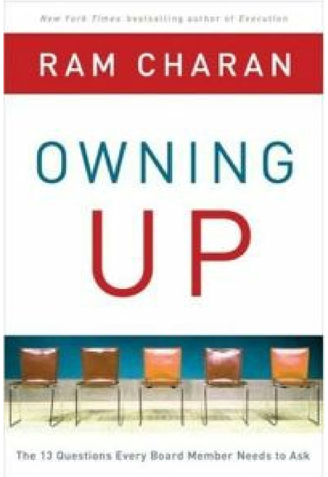


# Book Owning Up

## The 14 Questions Every Board Member Needs to Ask

Ram Charan
Jossey-Bass, 2009
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## Recommendation

Corporate directors have their hands full. They must help their companies prosper, keep their shareholders happy, establish sensible CEO performance standards, and evaluate strategy and risk in a volatile business climate. How can board members keep all those balls in the air? These dilemmas have no easy answers, but Ram Charan, best-selling business author and leading expert on corporate governance, provides excellent suggestions for this formidable balancing act. Though his text sometimes digresses – interestingly – from its mission, Charan provides board members with many useful, if not entirely new, insights. If you are a corporate director or even if you sit on a nonprofit's board, *BooksInShort* believes you can gain a lot from reading this superb, savvy book.

## Take-Aways

- Corporate boards are no longer passive rubber-stamps for the CEO.
- Directors must exercise governance, oversight, accountability and leadership.
- To diagnose if your board is fulfilling its mission, ask these questions:
- Does the board have the right members, a good "lead director" and an effective governance committee?
- Is the CEO doing a good job, and is his or her compensation appropriate?
- Does the firm have an executive succession plan and a bank of potential leaders?
- Is the board ready to handle a crisis and cognizant of the company's risks?
- Are the directors sufficiently well-informed for governance and strategy setting? Do they know how to lead without micromanaging?
- Is the board making the most of its time? Is it holding executive sessions and conducting self-evaluations?
- Does the board work well with "activist shareholders and their proxies"?

## Summary

### Hard Times for Directors

Directors face an unsettling new situation. With many businesses struggling, and corporate watchdog groups demonstrating increasing bark and bite, CEOs aren't the only ones taking the heat. Now, public attention turns also to boards and individual directors. In response, they must demonstrate maximum accountability and leadership, "not just over-the-shoulder monitoring and passive approval." How can boards do this best? To find the answer, directors should ask the following 14 tough questions about their primary challenges:

## 1. Does Your Board Have the Right Members?

Depending on your industry, and your firm's competitive and operational situation, your board probably needs some specialists. Are you entering a market in China? If so, you need a board member with China expertise. Is logistics a major challenge? Then add a supply-chain expert. The governance committee must ensure the right mix of members. To diagnose the board's strengths and weaknesses, have each director fill out a "skills matrix." Anticipate the expertise the board will need in the future – for example, comprehensive knowledge of capital markets or innovation processes – not just what it needs now. Target new directors who have the necessary know-how and personalities that will mesh well with the other board members. The governance committee should make annual recommendations concerning "board composition and succession."

## 2. Is the Board Paying Attention to the Organization's Risks?

Boards that do not emphasize risk management are liable to see their companies suffer. Risks can be internal, as they were in Enron, or external, like they were in the 2008 financial implosion. Some risks develop almost overnight – for instance, the 2008 oil-price hike. Risks do not have to be imminent to be dire; consider global climate change. Boards must balance management's response to risk against profitability and other concerns. For example, can your company refinance its short-term debt quickly if necessary? Boards need to have a handle on potential risks before they turn into full-blown disasters. View financial risk, the most crucial kind, in terms of the economy overall, and in light of your industry, "strategy and operations, politics and geopolitics, reputation and corporate culture." Name a risk committee as the board's watchdog. Make sure the board explicitly discusses risk at least once a year.

## 3. Is the Board Ready to Act in a Crisis?

Some disasters are impossible to foresee. They can come out of nowhere and cause devastating ruin. They are "unknowable unknowns." Other disasters are "knowable unknowns," that is, they are disruptions that have happened before, usually at random. If a disaster hits your firm, the board must assist with damage control. Boards often can mitigate some negative effects of knowable unknowns by acting in advance. Many businesses form crisis teams to deal with possible disasters. Boards should assess and review their companies' crisis control plans. Planning for unknowable unknowns is impossible, but the board can play a useful role if such a crisis happens. It can ensure that the crisis team includes people "with the skills to seek and sift through information from a large variety of sources" and who can "construct multiple scenarios on the fly." It also must be prepared to take charge if management falters during the crisis.

## 4. Is the Board Ready to Select the CEO's Successor?

The board has the critical responsibility of determining who will lead the company, knowing that a CEO can make or break a firm. A CEO candidate's personality and business strengths are crucial, but also make sure the person you select matches the company's "strategic direction and the business environment." Every board should have a list of strong, vetted CEO candidates and be ready to approve a new leader within a couple of years or more quickly, if necessary. In an emergency, a board must be ready to name a new CEO immediately. Boards need a succession system to spot and nurture potential leaders early in their careers. The board should enhance these up-and-comers' professional capabilities and accelerate their development so it always has a good bank of candidates. Although the board, not the CEO, selects new leaders, include the CEO in succession planning.

## 5. Does the "Board Own the Strategy"?

Developing and implementing the right corporate strategy is vital and the board must contribute. As business volatility increases, current strategies may not make sense in the long run. Some CEOs think that directors should not be involved in strategy, since they may not understand the business in a nitty-gritty way. But this can be an advantage when it comes to strategy. Board members are not liable to suffer from a myopic "can't see the forest for the trees" viewpoint. The board must be engaged strategically with the firm's "business units," its "portfolio" (its "product lines" or "technologies"), and its "functional capabilities," that is, its ability to do what it wants. The board's knowledge can help management clarify strategy. The CEO should present the company's strategy and receive feedback during the annual board retreat.

## 6. Does the Board Have Enough Data for Good Governance?

Effective management and oversight requires quality information. This includes nonfinancial data, such as Food and Drug Administration approvals, backlogs on orders and supply-chain performance. The board needs to know what is going on outside the company (e.g., competitors' margins and marketing activities). Management should give directors information on "short-term benchmarks" as well as employee recruitment and retention. Assign at least one director to work with management to secure the right information. Set the data up in easy-to-understand dashboards, including management commentary when necessary. PowerPoint presentations are usually one-way affairs. The board should insist on back-and-forth discussions about every presentation. Boards should also seek insights from employees and from experts outside the organization.

## 7. What Is the Best Way to Determine CEO Compensation?

Planning CEO compensation is a sticky matter. The global economy is changing and stock prices are in constant motion. In this volatile environment, how should boards properly compensate CEOs? A strict formula will not work. The board should establish a "compensation philosophy" outlining the main factors involved. Account for the CEO's completion of major goals, a "range of performance targets" and "uncontrollable macro factors," such as capital market flux. All board members should participate in CEO compensation decisions. Consultants are helpful, but the board should do its own homework on compensation trends. Anticipate some CEO tension about this topic.

## 8. Does the Board Have the Right "Lead Director"?

Without a strong leader who can promote effectiveness and collegiality, your board can become "factionalized, unfocused and indecisive." The right leader will keep the board cohesive, engaged and moving steadily in the right direction. Good board leaders are great communicators who can explain the board's viewpoint to management. They help decide which issues the board should debate. Along with the CEO, the lead director keeps meetings productive. He or she is the vital link between the board members and the CEO. Choose a lead director based on his or her business judgment, social skills and personality traits, such as “composure, an even temperament, courage and containment of ego.” The members should establish the leader’s mandate.

### 9. Is the Governance Committee Doing Its Job?

The governance committee has a vital task: ensuring that the powerful CEO still answers to the board. This committee, which should have three to five members, must make sure that the board has the right “people, processes and leadership” to do its work. The governance committee has several ways to make sure that the board meets its responsibilities, including carefully selecting board members and the lead director, monitoring planning-committee activities and assuring the smooth transmission of board strategies. It should establish the right balance “between managing and governing,” and conduct routine evaluations of how the board functions. It can draw upon educational programs and other resources to learn “best practices in corporate governance.”

### 10. Is the Board Making the Best Use of Its Time?

Board memberships are not sinecures. Directors must work hard and put in the time necessary to get the job done. This may mean “full-day board meetings, committee calls,” other sessions as situations demand and “lots of preparation time outside of the boardroom.” By the same token, ensure that every minute you devote to board business is well-spent. Don’t waste time on bureaucratic details, including myriad resolutions. Instead, focus on important issues, such as “strategy, risk and succession.” Narrow the board’s priorities to no more than half a dozen issues for the upcoming year. Organize a “12-month priorities list” to discuss at board meetings. Management must help by providing succinct reports on primary corporate issues.

### 11. “Can Executive Sessions Help the Board Own Up?”

Executive sessions are board gatherings without the CEO, although he or she might participate in the opening portion of the meeting. Such assemblies, which enable directors to speak frankly, are a valuable innovation in corporate governance. Outside directors particularly like executive sessions, which are good forums for discussing vital issues without appearing naive or ill-informed. Expect executive sessions to provoke some initial degree of strain between the CEO and the board. However, such meetings eventually can enhance their relationship. Holding executive sessions two or three times a year allows the board to focus on its primary concerns, which may include worries about senior executives. In an executive session, the lead director should ask broad questions and open the floor for candid discussions.

### 12. Can Self-Evaluation Improve the Board’s Work?

The best way to know if your board is performing well is to carry out evaluations. The board must formally examine the caliber of its rulings and activities. Your board should conduct a meaningful self-evaluation of its operations and output. The best way is for the lead director (or governance committee chair or an outside expert) to “ask open-ended questions in one-on-one interviews.” The questions and the way the interviewer synthesizes the answers both matter. Equally vital is the facilitator’s credibility. As your board critiques itself, understand that board decisions may take years to evaluate properly. Critically examine the board’s leadership and conduct peer reviews. Be sure the board follows up on the evaluation’s findings with meaningful action.

### 13. How Can the Board Quit Micromanaging?

Does your board spend too much time digging through the weeds instead of focusing on the landscape? Let management attend to operational details. Spending the board’s limited time on micro issues is inefficient. Indeed, it can be counterproductive, putting the CEO on the defensive while turning the board’s attention away from “strategy, perception of external trends, succession and enterprise risk.” Of course, knowing when your board is delving too deeply into the minutiae isn’t easy. During board meetings, don’t lecture or grill the CEO. When it comes to the CEO’s question-and-answer sessions, the way you ask for information makes all the difference. Pose broad questions, such as, “What is our process for adjusting prices as inflationary conditions change?” Or, “What benchmarking are you doing to improve pricing processes?” Don’t harangue the CEO about minor points. The lead director should help other directors avoid micromanaging.

### 14. How Well Does the Board Handle “Activist Shareholders and Their Proxies”?

As a result of the Sarbanes-Oxley Act and related regulations, U.S. shareholders are thoroughly engaged in how companies manage their affairs. Some activist shareholders insist on board seats for themselves or their proxies. Previously, shareholders would communicate with the CEO or chair. Now, directors often speak directly with shareholders. Appoint one board spokesperson to handle all shareholder communications. Treat activist shareholders with respect. Deal with their concerns – usually management, finances, operations and asset value – in a substantive way. Seek experts who can determine the validity of investors’ issues. Don’t freeze out directors that investors appoint. Be open with investors and proxy or advisory groups, but don’t let them bully the board.

## About the Author

**Ram Charan**, Ph.D., advises CEOs and boards. He is a popular author who has published 15 other business books, including *Execution*, a bestseller he co-authored. He is a member of three corporate boards. *Directorship* magazine named Charan one of its top 100 directors.