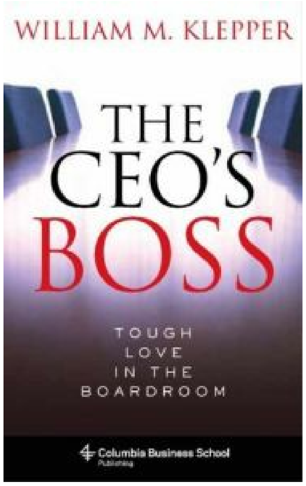

Book The CEO's Boss

Tough Love in the Boardroom

William M. Klepper
Columbia UP, 2010
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Recommendation

Enron. Global Crossing. WorldCom. Adelphia. Tyco International. These corporate cautionary tales point to the crucial importance of responsible corporate governance, something in shockingly short supply in recent years. In this book, Columbia Business School Professor William M. Klepper discusses why boards must show "tough love" to CEOs to keep them in line with corporate goals. He details how a "Social Contract" can set the working partnerships between directors and CEOs. Klepper, a management expert in board and executive relationships, has worked on executive education with some of the world's best-known firms, including AT&T, Sony and Johnson & Johnson. He tends to refer to these experiences and his credentials frequently, name-dropping with abandon. But maybe his self-promotion is justified, because he sure knows his subject. *BooksInShort* thinks board members and CEOs will learn a lot from Klepper's insightful, instructive and fascinating case histories.

Take-Aways

- Spectacular corporate failures like Enron and WorldCom, along with the economic crisis, have put a laser-like focus on corporate governance.
- "Social Contracts" keep boards and CEOs allied by spelling out their partnership.
- CEOs need "tough love," or strict but well-intended scrutiny, from directors.
- Boards must understand their CEOs' personalities and leadership styles.
- Four leadership styles – "the driver leader, the expressive leader, the amiable leader" and "the analytical leader" – typify executive managers.
- CEOs should adjust their behaviors to their company's stage in the business cycle.
- For example, a driver leader works best in a start-up or rescue, and an expressive leader relies on gut instinct to guide early successes.
- Cementing a corporate culture requires the relationship skills of an amiable CEO, and an analytical leader is adept at defining processes as a firm matures.
- Using "soft metrics" to measure a CEO's communications skills and strategic thinking is as important as judging his or her financial results.
- The top CEO candidates are those who can adapt to the firm's present and future needs.

Summary

"The Social Contract"

In 2005, then-Chairman and CEO Dennis Kozlowski and then-CFO Mark H. Swartz of Tyco International were convicted of embezzling $600 million from the company, and each received a stiff prison sentence of 8 to 25 years. In the aftermath, Tyco's new lead director, Jack Krol, and CEO and Chairman Edward D. Breen were determined to clean things up to save the firm. Breen decided to take on an entirely new slate of board members. He and Krol committed themselves, and the new Tyco board, to Tyco's "Ethical Conduct and Board Governance Principles."

This Social Contract sets "integrity, compliance and accountability" as primary ethical goals for Tyco's board and management, and it helped Krol and Breen return the company to respectability. All companies need a Social Contract to define the "beliefs and behaviors" of the CEO and the board. Prepare one for your firm and keep it "in the boardroom and on each member's board agenda." The path to outlining a typical Social Contract begins with outlining five corporate "behavioral standards":

1. **"Commitment to values"** – A "leadership credo" states an organization's bedrock principles. Johnson & Johnson's credo guided its response to the 1982 Tylenol crisis, when tainted medicine led to a massive drug recall.
2. **"Commitment to the stakeholders"** – A company's "four legs of the stool" – clients, workforce, investors and society – must be in balance.
3. **"Commitment to risk assessment"** – Responsibility compels both the board and the CEO to monitor a corporation's "strategic risk profile."
4. **"Commitment to transparency"** – Honesty and "full disclosure" ensure teamwork that is "hard on problems, not on people."
5. **"Commitment to coaching"** – A coach help directors and CEOs work better together.

What Can Happen Without a Social Contract

Software company Take Two Interactive (TTWO), which created the wildly successful "Grand Theft Auto" series, had the super-hot video gaming industry by the tail when it went public in 1997. Started in 1993 by 21-year-old programming genius Ryan Brant, the company threw off strong sales and profits throughout the '90s. Brant could do pretty much as he pleased as CEO; his board of directors was packed with investors and insiders who cared more about short-term gains than about long-term stability and growth. The constantly changing makeup of the board and the company's opaque operations meant that instituting a viable Social Contract was nearly impossible.

The Need for Tough Love

In 2001, TTWO began to experience difficulties from the dot-com bust and watched its earnings and share price decline. The Securities and Exchange Commission (SEC) investigated the company's accounting practices, and *The New York Times* published a story exposing conflicts of interest that compromised investors and management. By then, Brant had ceded his role as CEO but continued as chairman of the board. Then a hacker discovered that the "Grand Theft Auto San Andreas" video game had obscene imagery embedded in its computer code. Major retailers refused to sell even the cleaned-up version. Shareholders began lawsuits against TTWO for shady dealings. Management tried to shake off board inquiries, but SEC subpoenas led to Brant's pleading guilty to backdating stock options for management and board members, including the head of the audit committee. TTWO's directors and executives failed on each of the five standards of a strong Social Contract; its board lacked independent directors who could dole out "tough love," or harsh scrutiny applied with good intentions, to Brant and his successors. Corporations must have more than just words on paper to do the right thing. Ironically, Lehman Brothers trumpeted its "Sustainability Principles," core beliefs it held about values, transparency, risk management and stakeholder concerns. Yet Lehman's independent Finance and Risk Committee – which included a Broadway producer, a US Navy veteran, and a Spanish-language television operator – met infrequently, asked few questions and never challenged CEO Richard Fuld. The committee's lack of tough love eventually proved disastrous for Fuld and the company.

> "It is time to re-examine the role of the board and to explore how board members can best achieve their role as 'the CEO's boss'."

In addition to offering tough love, a board of directors is obligated to:

- **"Know the CEO's behavioral style and leadership practices"** – Personality directly affects a CEO's leadership style: The more the board knows about the former, the better it can anticipate the latter.
- **"Know the organization's needs" –** What are its main concerns and strategy? What "performance and opportunity gaps" present a challenge?
- **"Match the organization's needs with the leadership that is required"** – Different points in a business's life cycle call for different aspects of a CEO's persona: Start-ups need a leader to "challenge the status quo"; early successes warrant a CEO who will "inspire the future"; business maturity requires an executive who will "enable others" to continue achieving; and at its pinnacle a company should have a CEO who will "model the way" toward reinvention.
- **"Look first at the CEO and then the senior team to find the correct match"** – You need a deep executive bench that can anticipate your company's future. Former GE head Jack Welch excelled at creating a top team; one member succeeded him, while the others went on to great successes outside the firm.
- **"Look elsewhere if the correct match isn't found"** – The board's responsibilities include the difficult but sometimes necessary job of recruiting externally. Tyco got back on track by hiring outsider Breen as its chief executive.

Leadership Styles

The "Social Styles" developed by TRACOM, a consulting firm, help board members understand how CEOs act, particularly under stress. Your CEO should "take a Social Style assessment" measuring assertiveness and responsiveness. The test captures four distinct leadership styles:

- **"Driver leadership"** – Thriving on results and control, driver CEOs work best when they can take decisive actions. For example, Jack Welch cut a quarter of GE's staff in five years to achieve "maximum efficiency."
- **"Expressive leadership"** – These executives lead with their gut feelings and spontaneous responses. But they can be impulsive; they'll want to move on when details obscure their grand vision.
- **"Amiable leadership"** – Building strong relationships to advance the firm energizes an amiable CEO. Former JetBlue head David Neeleman blended amiable and expressive approaches in launching his airline.
- **"Analytical leadership"** – These CEOs depend on data and rational thought to manage through problems. Coca-Cola's Doug Ivester was a terrific analytical executive, but he failed as CEO when he could not adapt his leadership style to Coke's changing needs.

> "If an unsuccessful relationship between the board and the CEO can lead to disaster, then a productive one can help restore or avert it."

According to the "Integrated Leadership Model" (ILM), an ideal CEO leadership style exists for each stage of a company's evolution. The driver excels in start-ups and in rescuing declining firms, the expressive leader builds shared vision in early stages, the amiable leader cements relationships as business progresses, and the analytical leader defines the process for achieving goals. But CEOs need to be agile: They must be able to adjust their basic leadership style to their companies' positions and needs. Barring that chameleon-like ability, they should ensure that their executive team members can fill in any missing management talents.

"Soft Metrics"

Board members find it easy enough to measure a CEO's performance against the firm's "hard metrics," that is, financial measures such as returns on assets, equity and investment. However, a board also should look at how its CEO ranks on soft metrics, such as "integrity, leadership, developing internal candidates, communication skills and strategic thinking." Because of the CEO's pivotal role, these qualities can be critical to the company's prosperity and survival.

> "In its final form, a Social Contract answers the question of 'what we stand for' in a board/CEO partnership, and details the beliefs and behaviors that define their collective leadership."

For example, just six months before Lehman's bankruptcy in 2008, its board awarded $40 million in stock and cash to CEO Fuld for "successfully navigating the difficult credit and mortgage market environments and maintaining the firm's strong risk controls." Fuld, an analytical leader, had to that point delivered stellar economic results for his company. Yet an article appearing later that same year described Fuld's style as "authoritarian" and dismissive of differing opinions or discordant comments: "Woe to the messenger who came to the 31st floor bearing bad news." If Lehman's directors had compensated Fuld based on soft metrics, they might have gotten a more open and accessible CEO who could alter his manner to confront changing times.

A New CEO

As board members evaluate candidates, they should guard against personal biases and look for a leader who can best support present and future corporate needs. Directors should follow this four-step process when considering a new executive leader:

1. **"Strategic context and intent"** – Before talking to a prospective CEO, board members need to reassess company strategy. They should analyze the firm's fit in its "competitive environment" and ask these important questions: "Where will we compete?" "How will we get there?" "How will we win?" "What will be our speed and sequence of moves?" Once the board has refined its strategic thinking, it can interview CEO candidates to determine how they can help the organization achieve its objectives.
2. **"CEO's agenda, practices and style"** – The board should determine if CEO candidates line up with the company's strategic objectives and place in the business cycle. Directors should not just listen to what CEO nominees say, but how they say it.
3. **"The alignment of the business system"** – What parts of the business do not align with current strategy? Highlight these, as they represent an incoming CEO's top priorities.
4. **"The congruence between strategy, CEO and business system"** – Board members should query CEO aspirants on their approaches to the organization's "structure, process, people" and "culture" to see if they are in step with the board.

> "Effective board dynamics do not occur by chance."

A board and its new CEO must "agree on what matters" if they are to work together. They should meet periodically – at least "at the beginning, midterm and end of an organization's year" – to examine how well their partnership is doing. They each must identify problems that interfere with a smoothly functioning relationship and develop a detailed action plan to address them.

Team Dynamics

Board members should exploit their own particular strengths – identifying the "consensus builder, idea generator" and "change advocate" among them – to improve their own interactions. The chairperson plays a crucial role in directing, coaching and supporting the other members; in the US, CEOs take on this function 54% of the time. Alternatively, a lead independent director (LID) can assume board-related tasks, freeing up the CEO chairman to focus on executive duties.

> "When CEOs derail, the whole company feels the crash."

Spectacular corporate failures like those of Enron and WorldCom, along with the economic crisis, have put a laser-like focus on corporate governance. In the coming decade, government scrutiny is apt to accelerate, boards will open up to become increasingly egalitarian, directors will campaign for their board seats, shareholders will help choose the chairperson, LIDs will take over all board processes and corporate risk management will rise to the top of every board agenda.

About the Author

William M. Klepper is a professor of management at the Columbia Business School, and he directs Columbia University's partnership with the Outstanding Directors Exchange.