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What's on Your Mind?

Share and Discuss the Corporate Governance Issues Impacting Your Business

Independent Chairman / Lead Director / Governance Committee Chair Roundtable

Thursday, November 17, 2011
12:30 p.m. – 1:45 p.m.

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Independent Chairman / Lead Director / Governance Committee Roundtable Discussion

November 17, 2011

Roundtable Moderators

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Roundtable Presenters

- **Ari Buchler**
  - Senior Legal Executive and Corporate Advisor
- **Todd Krasnow**
  - Highland Capital Partners
- **Oleg Pohotsky**
  - Managing Partner, Right Bank Partners

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Roundtable Topics

- What is the typical role of a Lead Independent Director as compared to other Directors?
- Is having an Independent Chairman or Lead Independent Director for optics or does it make a difference for how the board operates?
- Is an Independent Chairman or Lead Independent Director valuable in day-to-day board matters or only in times of significant change?
- How does a Lead Independent Director role take hold in a newly public company?
- Should the position of Lead Independent Director rotate on some fixed interval?

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Lead Independent Director Role

- The creation of a Lead Independent Director responds to the fact that the Chairman's role and the CEO's role are quite different.
- The Chairman is the boss of the board and has primarily a governance role. The CEO is the boss of the business and has primarily a management role.
- Although there is a common goal, the two positions must necessarily emphasize different means of achieving that goal. It can be difficult for one to effectively steward the governance and business management functions of a company.
- One response has been to create a position of a Lead Independent Director.

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Arguments for a Lead Independent Director

- A Lead Independent Director offers a focal point for dissenting opinions. If the Lead Independent Director has a good relationship with the CEO, he or she can collect and funnel dissenting ideas to the CEO without fear of retribution. The fact that there may be a need for such a person is indicative of a problem whereby Directors do not feel comfortable offering dissenting opinions.
- It may be true that that Directors get paid to speak their mind, and should simply do that, but the practical matter is that not all Directors feel they are in a position to challenge the status quo. Formally appointing a lead director is one way to respond to the concern Directors may have about being singled out as a dissenter.
- A Lead Independent Director can help the company avoid the perception of the obvious conflicts of interest that arise with a combined Chairman/CEO. A credible Lead Independent Director can relieve pressure on the company to separate the Chairman and CEO positions.

Other Considerations for a Lead Independent Director

- A Lead Independent Director can create confusion in the chain of command.
- Each company must decide for itself whether a Lead Independent Director would be a valuable position to institute.
- When a Lead Independent Director is appointed, often this person runs the board meetings, focuses communications to the chairman and the CEO, and helps present dissenting opinions. Typically, however, the lead director has no authority to set the meeting agenda.
- It is important that if a Lead Independent Director position is instituted, the position is formally acknowledged, most likely in the by-laws, and that the position have formal responsibilities and authority.

Sample Lead Independent Director Charter Provisions

Sample Lead Independent Director Charter - Purpose

- Gilead Sciences Lead Independent Director charter purpose statement:

  "In circumstances where the Chairman of the Board of Directors is not independent, the Board of Directors considers it to be useful and appropriate to designate a Lead Independent Director to coordinate the activities of the other independent directors and to perform such other duties and responsibilities as the Board of Directors may determine."

Sample Lead Independent Director Charter - Responsibilities

- Owens Corning Lead Independent Director responsibilities include:
  - Preside at meetings of the Board in the absence of, or upon the request of, the Chairman.
  - Serve as designated member of the Executive Committee.
  - Preside over all executive meetings of non-employee Directors and independent Directors and report to the Board, as appropriate, concerning such meetings.
  - Review board meeting agendas in collaboration with the Chairman and recommend matters for the Board to consider and information to be provided to the Board.

Sample Lead Independent Director Charter – Responsibilities (cont'd)

- Owens Corning Lead Independent Director responsibilities also include:
  - Serve as liaison and supplemental channel of communication between non-employee/independent Directors and the Chairman without inhibiting direct communications between the Chairman and other Directors.
  - Serve as the principal liaison for consultation and communication between the non-employee/independent Directors and stockholders.
  - Advise the Chairman concerning the retention of advisors and consultants who report directly to the Board.

Sample Corporate Governance Committee Charter Provisions

Sample Corporate Governance Committee Charter - Purpose

- Carbonite Corporate Governance Committee charter purpose statement:

- "[The] Corporate Governance Committee of the Board of Directors of Carbonite...shall assist the Board with the discharge of its responsibilities relating to...[1] the structure and composition of committees of the Board, and [2] corporate governance matters."

Sample Corporate Governance Committee Charter - Responsibilities

- Carbonite Corporate Governance Committee responsibilities include:
  - The Committee shall approve the charter for each committee of the Board.
  - The Committee shall consider, develop and recommend to the Board policies and procedures with regard to the nomination of directors or other corporate governance matters as may be required, or required to be disclosed, pursuant to any rule promulgated by the United States Securities and Exchange Commission or otherwise considered appropriate by the Committee.
  - The Committee shall consider and make recommendations to the Board with regard to any proposed changes to the Company's certificate of incorporation, bylaws, or other corporate governance guidelines, policies or procedures.

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Sample Corporate Governance Committee Charter – Responsibilities (cont'd)

- Carbonite Corporate Governance Committee responsibilities also include:
  - The Committee shall be responsible for overseeing an annual self-evaluation of the Board to determine whether it, and its committees, are functioning effectively. The Committee shall determine the nature such evaluations, supervise the conduct of such evaluations and prepare assessments of the performance of the Board, to be discussed with the Board.
  - The Committee shall be responsible for oversight of, and ensuring compliance with, the Company's corporate governance policies and its Code of Business Conduct and Ethics.
  - The Committee shall have the authority to conduct or authorize investigations into any matters within the scope of its responsibilities as it shall deem appropriate, including the authority to request that any officer, employee, or advisor of the Company meet with the Committee or any advisors engaged by the Committee.

Corporate Governance – Beyond Compliance

An analysis of board dynamics and a suggested methodology for building and maintaining effectively functioning boards of directors

Synopsis:

An effectively functioning Board requires unified mission focus, unit cohesion and sustained engagement. Unified mission focus can be best achieved by organizing the board around the enterprise's sustainable business model. Unit cohesion and sustained engagement require a dedicated role for the board chair to focus on board communication and board engagement.

State of Affairs -2011

McKinsey Quarterly; July. 2011. Reporting a global survey of 1,597 corporate directors, 31 percent of them chairs, the survey found that: (1) 64% have less than complete understanding of their company's financial position; (2) 79% have less than complete understanding of their company's strategy; (3) 84% have less than complete understanding how value is created in their company; (4) 86% have less than complete understanding of the risks their company faces; and (5) 90% have less than complete understanding of the dynamics in their company's industries.

Consider this situation as you read on.

Rethinking Governance: toward sustained value creation rather than sterile process

Despite much discussion in academic literature and in the popular business press about the need for effective corporate governance and the various means for achieving it, corporate problems that can be ascribed to inadequate governance seem to be come up at a disturbingly persistent rate. Since boards are generally populated by competent, thoughtful, well intentioned persons, there has to be some fundamental reason for the persistence of these problems and that reason, most likely, is the excessive focus on sterile process; on mechanistic proceduralism. The most glaring manifestation of this is the degree to which the board agenda book has come to serve as the singular mechanism through which individual directors engage together as a board.

This article makes the case for an approach that could improve the effectiveness of directors individually and of boards as functional groups. To achieve this, the directors' focus must be redirected away from an ever-changing and ever-growing litany of procedural items primarily intended to make sure that mistakes are avoided. Instead, their focus should be directed toward engaging actively and positively to arrive at a shared understanding of the enterprise business model and then, using that shared understanding, to create value and proactively protect that value by anticipating and avoiding pitfalls. The term "enterprise business model" is intended to capture both the generalized and distinctive rationale for how a particular organization creates, delivers and captures value.

Recognizing the limits of any analogy, in comparing these two different approaches to fulfilling a board's mandate, one could think of the typical difference between a doctor focused on simply treating various disease symptoms as they present themselves and a physician who thoroughly comes to know a patient, the patient's environment and the patient's behavior and then works with that patient to help protect the patient's health and enhance the patient's quality of life.

By making the explicit effort to develop a shared fundamental understanding of the enterprise business model, the board will be prepared to coalesce around a unified mission focus, encouraging cohesive functioning of the board as a group and facilitating sustained engagement over time by each individual director. Such a holistic approach, broadly practiced, should elevate the standard of stewardship achieved by corporate boards.

At the beginning of the current decade, much attention was focused on corporate governance in the aftereffects of the stock market "tech bubble" implosion and the shocks from the series of corporate scandals that followed on its heels. In this period, the most high profile scandals, complete with both civil litigation and criminal prosecutions, were Enron and WorldCom, which involved fraud to cover the failure of flawed business strategies, and Adelphia and Tyco, where insiders looted corporate assets. Much hand-wringing ensued and both a legislative and a regulatory response followed. However, the requirements that were implemented, including quarterly financial certifications and annual control systems reviews, were not able to prevent the fundamental governance failures at AIG, Bear Stearns or Lehman Brothers, which all occurred less than a decade after the previous scandals. For all the energy expended, these procedure-based efforts to channel corporate behavior had marginal overall impact. Obviously, the lessons from the first series of corporate scandals were never learned.

What should have been the singular lesson learned? It is that: fundamental flaws require fundamental changes, not just an overlay of additional procedures.

Boards of directors are generally perceived to be charged with two primary functions – protecting corporate assets and providing strategic guidance to the CEO that they hire for the development and execution of the enterprise's business plan. Enron and WorldCom reflected the failure to perform the strategic guidance function, whereas Adelphia and Tyco reflected the failure to protect corporate assets. While it is commonly thought that there is a tension between a board's oversight function and its value-added strategic function, these four corporate scandals demonstrate that both functions are important and a failure of either function can lead to ruin.

The challenge is to make the two functions complementary and mutually reinforcing. This is not a task amenable to setting up a "punch list" and "checking off" the boxes on the list. It requires a fundamental rethinking of how the energies of well intentioned individuals serving on boards are harnessed to a common good through the process of governance.

This essay first discusses recent developments in corporate governance and suggests how corporate governance can be further improved. It then analyzes the essential elements of a well functioning board and provides insight on how to develop a shared understanding among board members of the enterprise's business model. It concludes by analyzing the essential role that an independent chairperson should play.

Improving Corporate Governance: a brief review of prior efforts

As a result of the corporate scandals described above, as well as the mutual fund scandals and other lower profile events, the early years of this decade generated much discussion of corporate governance. This culminated in the passage of the Sarbanes-Oxley Act of 2002 ("SOX"). SOX generated persistent controversy regarding its value, in particular the appropriateness of the implementation of SOX Section 404 [1]. The U.S. Securities and Exchange Commission sought to reinforce these statutory initiatives by mandating that one particular category of institutional investors over which it had jurisdiction, that is mutual funds, affirmatively exercise their responsibility as owners by voting their proxies and disclosing, in detail, how they voted. Rather than prompting thoughtful exercise of owners' responsibilities, the requirement merely spurred the growth of corporate governance services which bloomed like the red tide from a cottage-scale guild to a full blown industry. One could argue that there has been more talk than productive action, but all the talk did have a beneficial effect. It has sensitized the environment that corporate governance inhabits, making that environment more fertile for accepting meaningful conceptual change in governance if such a change were to be presented.

Until now, no such fundamental change has yet been presented. For all the energy expended on the subject matter of corporate governance, the most direct result has been a focus on, at best, meeting and, at worst, gaming the various compliance requirements that have been promulgated. Implementation of SOX Section 404 provided the potential opportunity to rethink both processes and process controls for running a business. The potential opportunity was to make the enterprise financial control system a means for analyzing and controlling operations and to make the accounting system a more useful source of insight on the performance of the enterprise. However, SOX Section 404 implementation has instead most often been reduced to reviewing, not rethinking, existing processes, "checking off the boxes" on yet another nearly standard "punch list" and just filling in whatever "dings." might have appeared.

If SOX Section 404 had led to a fundamental rethinking of business processes rather than providing an additional source of audit firm revenue to replace proscribed consulting services, then the SOX-mandated certifications of the chief executive officer ("CEO") and the chief financial officer ("CFO") would be a meaningful exercise and not a high-wire act of legal liability. After all, doesn't it make sense that if the CEO and the CFO are to be held personally liable for a false certification of the firm's financial statements, then for their own protection, they should have a control system on which they can rely? And if the control system is reliable, why can it not also be useful for real time decision-making? How many CEOs and CFOs, or boards for that matter, saw SOX Section 404 as such an opportunity rather than just another hoop to jump through? In the existing process driven governance culture, few boards thought about of

[1] SOX Section 404 required that all publicly-traded companies establish internal controls and procedures for financial reporting and required documentation, testing and maintenance of those controls and procedures to ensure their effectiveness. This requirement has been modified for smaller companies by the recent Dodd-Frank Wall Street Reform and Consumer Protection Act.

how to respond to the statutory mandate of SOX in a fashion that had the potential to improve the fundamental operating strength of the enterprise.

Despite periodic bemoaning that directors simply don't perform up to snuff; that they are insufficiently attentive; that they are overstretched in the demands on their time; it is fair to say that, in times of crisis, more often than not, boards respond effectively. This validates the premise that the raw material of capable, motivated individuals is present on most boards. What is it that makes them rise to the occasion in time of a crisis? The answer is that, at a time of a specific challenge, they are focused; they are working together; they are fully engaged. Is there a way to achieve such performance, such behavior, on a sustained basis rather than just in the face of an imminent threat?

To improve substantive corporate governance requires rethinking the organizing concept of how a board of directors functions so that the inherent capacities of the individual board members are fully utilized.

Cornerstones of a Well Functioning Board

It is useful to "set the table" for the proposed solution by first describing what might constitute the key elements of a well functioning board; diagnosing the major reasons why such characteristics do not generally prevail and then offering a solution. I would posit the following as the essential pillars of a well functioning board: unified mission focus and unit cohesion, both sustained by purposefully structured persistent engagement. Unified mission focus requires a shared view of goals for the enterprise and the tasks required to achieve those goals, while unit cohesion involves well developed relationships based on trust and mutual respect. How else but through shared goals, trust and respect can a group of peers, who assemble only periodically as a group, operate under the constant and persistent uncertainty that characterizes a modern enterprise operating in the global marketplace?

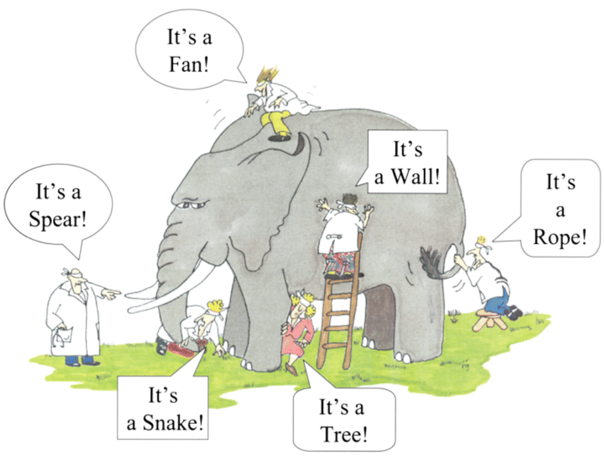
Unified Mission Focus

While publicly dysfunctional boards on the scale of Hewlett Packard during 2006 are an exception, the reality is that most boards usually just muddle through. Is this due to lack of skill and energy on the part of directors? Likely not, since boards generally respond effectively to crises. The reason for this differentiated performance in times of crisis is that boards are generally composed of accomplished, experienced individuals who, harnessed in response to a crisis and energized by a clearly visible challenge, bring to bear their range of complementary skills honed by diverse experiences, to deal with the situation. The assignment for all of us is to find how to harness this available capacity on a sustained basis, albeit at a less heightened level, for the on-going benefit of the enterprise; in the process anticipating and preventing problems rather than responding to them.

Unit Cohesion

If a board is to arrive at a mutually understood and agreed upon sense of mission for the enterprise, and if issues and concerns are to percolate at an early stage when details are not yet clearly defined, there needs to exist a level of intimacy among the board members so that individual directors can be confident they can expose their own uncertainties and only partially developed ideas in pursuit of a common set of agreed upon objectives. This doesn't happen by itself. It requires thoughtful, dedicated, persistent leadership. The intensity of the effort required does not lend itself to one person doing double duty. Achieving board focus, board bonding, board engagement requires the dedicated effort of an independent chairperson concentrating exclusively on these factors.

Creating a Shared Understanding of the Business Model



Typical understanding of Enterprise Business Model based on "The Board Book"

Before thinking through how to accomplish the harnessing of the directors' diverse skills and experiences on a sustained basis, it is worth reflecting on what the "part-time" nature of board work is in practice today and what it should be.

The organizing tool of most boards today is the meeting agenda and associated materials that constitute the "Board Book." In fact, the Board Book, in many cases, is more than just the organizing tool; it becomes an end unto itself and the sole vehicle for the board's engagement. This is ineffective and destructive in more than one way, but, most directly, it implies that the "part-time" nature of board work involves a periodic, finite and limited slice of time, a day or two days on some predetermined schedule. In this construct, the director is permitted to be disconnected until his or her attention and temporary, finite engagement are triggered by the arrival of the Board Book. The "bell is rung" and they enter the ring to spar a short round. Such a construct is wholly inappropriate.

While board work is indeed "part-time," it should be "continuously part-time" not "episodically part-time." Board members are generally accomplished professionals who, if properly conditioned, are capable of attenuated sensitivity to more than one item at a time, of being aware, as they go about their various tasks, of how information they are interacting with in all their diverse activities might affect the enterprise on whose board they serve. The goal should be broad, continuous engagement by the director, the dedication of a persistent horizontal slice of time to thinking about the enterprise, not mere reaction to issues triggered and narrowly delineated by the Board Book.

If the Board Book is the wrong organizing concept for board engagement, then what is the correct concept? What is the organizing concept that can create continuous engagement and elicit maximum contribution from members of the Board? It is a shared thorough understanding of the enterprise's business model. This shared understanding is the foundation for achieving maximum effectiveness, as well as efficiency, from the board.

Benefit of Shared Understanding based on Shared Experience

A mutually understood and agreed upon mission for the enterprise does not develop by happenstance or osmosis, either. It must be sought after through persistent effort in common. If issues and concerns are to percolate at an early stage when the outlines are not yet clearly defined, there needs to exist a level of intimacy that permits individual directors to be confident that, in pursuit of a common set of objectives, they can expose their own uncertainties, their own half-baked ideas. Effective open communication and cooperation can not be fully realized if, by default, it is limited to scheduled, formal meetings.

It is assumed that a well constructed Board will have a diversity of skills and experiences. Those skills and experiences will affect the lens through which each director interprets information. How does one then create a shared, as well as thorough, understanding of the enterprise business model? The best way to shared understanding is through shared experience. But what might such an experience be? In what setting might one find a diverse group of skilled individuals coming together to immerse themselves in the details and essence of an enterprise in order to gain a shared understanding of that enterprise?

One parallel that should be instructive is the process by which investment bankers, often from more than one firm, gather to become "schooled" in the essence and details of an enterprise in preparation for drafting the disclosure document for an offering. Drafting such document is a challenge because of its contemporaneous dual purpose; that is avoiding liability by fully disclosing potential risks and at the same time describing an attractive investment opportunity to support the marketing of the offering. Especially in the case of an initial public offering of equity, when information about the enterprise is not broadly available, the diverse group of highly skilled individual bankers is charged with coming to a shared understanding of the enterprise's business, its potential and the risks involved in realizing that potential, and then cogently and succinctly communicating both. The process of accomplishing this, generally referred to as "due diligence", almost universally starts with a continuous series of presentations by various teams of managers, over a period of usually more than one day, that describe in considerable detail both the business units and the functional areas of the company. While CEOs sometime desire to control and dominate such a series of presentations, the sheer volume of detail required in such an undertaking makes that difficult and provides the participating bankers with an opportunity to experience exposure to the elements of the business both in depth and with breadth. As themes emerge and inconsistencies are noticed among separate groups' presentations, both strengths and weaknesses become apparent.

It is not unusual for the kick-off meeting process to also have a cathartic effect on management's own understanding of and insights about the business. Because activities done often enough become repetitive and routine, experiencing an integrated review of the business can provide fresh perspectives that challenge established assumptions.

The key to the effectiveness of this process is that a <u>disparate group of individuals</u>, each with his or her own background, context, and biases, <u>hears and internalizes</u> the <u>same information</u> at the <u>same time</u> in what amounts to an immersion environment. The insights obtained and judgments drawn are as distinctive as the backgrounds and experiences of the individual bankers participating in the immersion, but when they, as a group, join in the task of conducting due diligence and drafting the prospectus, they come to those tasks with a shared and integrated knowledge base upon which to develop their interaction as a group and arrive at conclusions about the operative reality. As effective as this shared immersion can be for a disparate group of investment bankers who will hardly ever join together again, the same should apply all the more to a board of directors where the individual members have committed to the stewardship of the enterprise over time.

The suggestion is that, as an organizing principle for their efforts in common, the board periodically, perhaps every three years or whenever two new board members join the board, go through a process equivalent to the due diligence preparation of investment bankers getting ready for an offering. The parallels to the functioning of a board are obvious. Not only will the shared knowledge-gathering experience offer an unparalleled source of knowledge obtained and held in common among the board members, the shared understanding of the business and the key elements of the enterprise will lay the foundation for developing commonality of mission and the shared experience will build unit cohesion. Neither a series of isolated presentations over a set of regular board meetings nor an individual orientation program for each director can serve as a valid substitute.

This approach to organizing the sustained efforts of the board might be challenged as being too costly and too disruptive of management's activities. The short answer would be that that is the reason why it might only be done every three years. A more substantive answer would be that if corporate governance by a board of directors is foundational for how our economic activities are organized, the investment in time and energy to do it better is certainly justified. The effort required to do this well is non-trivial but should be a natural aspect of the responsibilities of the chairperson, highlighting again why that function needs to be distinct from the duties of the CEO.

The organizing principle of the board becomes a shared and multivariate understanding of the enterprise's business model by the members of the board and an explicit agreement among them as to the key success factors and the possible sources of potentially unacceptable risks. Each meeting's Board Book takes on a sense of continuity. It begins to reflect the challenge of executing on the agreed upon business model, weighing strengths, weaknesses and risks over time and in context. The Board Book stops being a compilation of current compliance items and problems "du jour."

Testing the Enterprise Business Model-centric Approach Against Past Debacles

Enron

Challenge to management when business model and financing strategy do not match

How might a board, focused on and organized around shared understanding of the company's business model, have affected the negative result of one of the highlighted corporate scandals, Enron for instance? Jeff Skilling clearly and openly characterized his vision for the company as consisting of a series of world class banks, each specializing in market segments where Enron would have a competitive advantage based on insights gathered from being a direct principal actor in that market segment as well as an intermediary. The first segment bank that Enron built specialized in natural gas, leveraging the industry expertise of the combined Houston Natural Gas and InterNorth (formerly Northern Natural Gas). The second "world class" bank that Enron set out to build was in the electric power sector. Consistent with its business model, Enron acquired Portland General, a Northwest utility, in order to gain the market insider's advantage. A broadband bank was to be the third bank in this series. It was but a half baked concept with little to show for it beyond a contract with Blockbuster when it was marked to market to generate more than $100 million in revenue. The scandal followed shortly thereafter.

What if the board had focused on the underlying elements of the business model rather than being distracted by the details of implementing various off-balance sheet financing mechanisms and adopting mark-to-market accounting? The exchange might have gone something like this:

"Jeff - we are setting out to build a series of "world class" banks, are we not? Given the volatility of bank earnings, the best of class, say Goldman Sachs, on its best day trades at two times book and mid to high teens multiples of earnings. If we are to be an aggregation of best of class banks, how can we sustain the growth company valuation multiple that underlies our financing strategy?" Note: Enron traded at P/E ratios as high as 69, not in the mid-teens.

This need to disguise the balance sheet of an aggregation of banks so that it did not look like a bank was the fundamental flaw that drove the various activities that gave birth to the multiplicity of scandalous acts.

If the Enron fraud arose from a business model that was incongruent with the capital structure of the company, the WorldCom fraud arose from a different source of failure, poor execution of fundamental elements of the business strategy. In the case of Enron, the board failed to persistently test the company's balance sheet capitalization and funding against its business model. In the case of WorldCom, the board failed to challenge Bernie Ebbers, the company's founder, on the execution of the very strategy that he conceived.

Ebbers set out to build an integrated nationwide communications carrier by "rolling up", acquiring and integrating, geographically disparate small and medium-sized companies. Because of their relative small scale, Ebbers was able to acquire these on attractive financial terms to the point that he was able to eventually "steal" MCI, a major operation, from under the nose of British Telecom. The key to the ultimate success of the "roll-up" strategy was integrating the acquired operations into a nationwide enterprise that could effectively service national-scale companies as the preferred telecommunications provider.

Ebbers got wrapped up in the excitement of mergers and acquisitions and never got around to integrating the companies. Sixty acquisitions resulted in 55 billing systems. Bills to national accounts were manually assembled at company headquarters in Jackson, Mississippi. Without functional integration there was no effective cost control and no efficiency of scale. Fraudulent profits had to be manufactured to make up for real losses. Had directors focused on the essential elements of the business model that targeted national accounts, would they not have pressed about the progress of integrating acquisitions to service those national accounts?

WorldCom

Barrier to achieving strategic goals without the essential infrastructure

Similarly and more recently, perhaps the board of AIG should have said to themselves: "We run some of the best insurance companies in the world. We understand the business model and the profitability that can be generated at acceptable levels of risk. What is it about the credit default swap segment that results in such disproportionately high profitability?" What might the review and analysis that would have followed that fundamental question have led to?

The organization of a board around a common understanding of the business model inherently leads to mission focus. Strategy is not the subject of an annual or biennial retreat. It undergirds all the efforts of the board, including ongoing oversight. Each director's distinctive skills and capacities are harnessed for positive, sustained input in the context of the business model rather than episodic reaction to isolated issues or pending crises. There is a natural basis for sustained, continuous engagement, even if normally it involves a relatively modest, part-time, horizontal, slice of time.

Benefiting from Independent Chairperson: leadership, team building and communications

While a shared understanding of the enterprise business model provides a natural foundation for sustained continuous engagement, building on this foundation to achieve unified mission focus and strong unit cohesion is a major undertaking. Organizing the triennial due diligence process, building and expressing the unified consensus, drawing out the special skills of individual directors, maintaining active communication and so on, are not secondary tasks. A thoughtful appraisal of the efforts required easily justifies the separation of the roles of board chairperson and CEO. Unlike the usual discussion on this subject, the justification for the separation of roles is not a concept of separation of powers or of checks and balances. Rather, the justification for the separation of roles is that each is different and distinct and that one person trying to do both will simply be overloaded and incapable of doing justice to both. In such a case, it is obvious that the functions involving the board would be the candidates for getting short shrift.

The CEO's role is well understood. Common aspects include leader, decision maker, most senior manager, visionary, and channeler of information up and down the organization. To this full menu of responsibilities is often added the job of being the "developer" of the board. That is probably one task too many and qualitatively different than all the others. With respect to the management structure of the enterprise, the CEO has full power and authority, but, with respect to the board, the relationship is one of a peer. The management structure of the enterprise is composed of full time employees, whereas the board members dedicate a portion of their time and energies. Therefore, the approach to each is qualitatively different. Given the responsibilities of the CEO in the authoritative role, it is not reasonable to also burden the CEO with dealing with the consultative role of chairperson of the board and expect the best results.

One might say that the expectation is that the CEO should dedicate at least 110% of his or her time and energy to the enterprise, dealing with what must be accomplished daily. However, the job of maintaining the effective engagement of a group of five or more part-time contributors does not fit neatly into a daily task schedule. It requires operating on a slightly different dimension and time horizon and requires probably at least another 30% of a full-time effort for the least complicated organization. The combination of these two roles is probably more than can be successfully accomplished by a single individual. However, an independent chairperson can effectively focus exclusively on the job of keeping the board members engaged. The chairperson can serve as aggregator of information about the enterprise, which can then be utilized in the context of the shared understanding of the business model. With knowledge of the profile of each individual board member, the chairperson can provide customized information to each board member that is contextualized for the skills and interests of that board member. The challenge is to keep the issues of the enterprise near the frontal cortex of each director as the director goes about his or her daily tasks. This would require regular, probably at least bi-weekly, communications, which would be an unreasonable burden to place on the CEO's list of tasks and likely be relegated to secondary status on the CEO's to-do list.

Getting full benefit on behalf of the enterprise of the resources usually embedded in the individual directors and the board as a whole (and often unrealized) deserves the dedication and attention of an individual specifically and exclusively charged with that purpose.

Conclusion

To summarize, board effectiveness can be best engendered by establishing a shared understanding of the enterprise's business model and making the business model the organizing principle for the functioning of the board. That shared understanding can be best achieved by providing a shared experience of the business operation through an analog to the well established and practiced process by which investment bankers prepare to underwrite a securities offering. Building on that shared experience and understanding, sustained engagement of board members must be achieved by establishing an expectation of continuous, not periodic, involvement and then nourishing that involvement through a formal communication/engagement process led by an independent chairperson. It is time for a fundamental change in how boards are organized and engaged, where the enterprise business model will define the board's agenda rather than the agenda determining the board's focus.

Oleg M. Pohotsky
Beverly, MA
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Oleg M. Pohotsky serves as audit and valuation committee chair of Hambricht & Quist Healthcare Investors (NYSE: HQH) and Hambricht & Quist Life Sciences Investors (NYSE: HQL), as well as Independent Non Executive Director of Agroholdings Avangard (LSE: AVGR). He is currently Managing Partner of Right Bank Partners, a corporate governance and strategy consultancy. His 30 year career in the investment industry has included both investment banking and private equity experience. He is a graduate of Clarkson University (BSChE), University of Miami Law School (JD) and Harvard Business School (MBA). He is a member of the Massachusetts Bar.

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