

Framing a Strategy for Board Development

By Michael Kipp and James Deitch

It has been said that governing boards are “incompetent groups of highly competent individuals,” yet in practice, there is no group in organizational life whose capabilities are taken more for granted. It is easy to make the case for systematic board development; the hard part is deciding where to begin and how to proceed. This article reports our experience with a proven framework for board development and provides a primer on how to use it. The framework is based on a trio of deceptively simple tools:

- Clear definition by the board of management’s boundary conditions.
- Rules of engagement, both *with* management and *among* directors.
- A factually robust context map shared by management and the board.

Taken together and seriously applied, they offer the prospect of both reduced exposure and enhanced governance.

Boundary Conditions

Boards govern best when they establish and maintain a set of *boundary conditions* that embody their vision and values, the broad strategy for the future, the legal and ethical constraints on behavior, and their preferences regarding key risk management tradeoffs. The chart in the next column illustrates the concept; two brief cases illustrate its utility.

Precision Component Fabricators (PCF) is a privately held company with an enviable record of performance in manufacturing parts for *Fortune* 500 industrial product firms

throughout the world. A new CEO was installed a number of years ago to replace the retiring incumbent. Several new board members were appointed at the same time. The revised board wanted to see investments in growth; the new CEO leaned toward production efficiency, the orientation for which he was originally chosen.

Boundary Conditions



Over time, market dynamics accelerated the tension between board vision and management action. The board wanted long-term, top-line growth; the CEO focused on cost cutting to maintain profitability. These forces came together to challenge a board more accustomed to being civil than being clear, both among themselves and with leadership.

A special session was held for the purpose of specifying boundary conditions, thereby clarifying the arena for executive discretion. One measurable dimension of the board’s vision that surfaced was a specific share-valuation target by the end of the decade. The risk management directive that emerged was a willingness by the board to sacrifice near-term profits in the interest of upper quartile performance in the future. This made it possible to calculate planning gaps, renew the company’s fundamental value proposition, and prepare detailed growth and reinvestment strategies. In the course of a spirited discussion, the boundary conditions framework kept the conversation focused on closing the gap between the board’s long-term goals and the CEO’s overemphasis on short-term profitability.

Director Summary: Create a strategy for board development by defining the conditions that bound executive discretion; delineating the rules of engagement for discourse; and mapping out the context in which “success” is to be understood and pursued.



PCF's boundary conditions were developed jointly between the board and the CEO, establishing both clear expectations and broad areas of executive discretion. The CEO accepted that a five-year share-price target was the driving aspiration for the board. Although the company had never completed one, acquisitions were considered a potential means to this end, thereby allowing the CEO the freedom to purposefully consider a very broad range of options with the full support of the board.

Benjamin Financial, Inc. (BFI), a bank holding company, represents a far less successful story. BFI was an amalgamation of multiple bank charters purchased over a period of 10 years. The holding company board was composed of a mixture of competent individuals and inherited major shareholders of the acquired entities. The board was dominated by a few legacy shareholders who installed an affable but weak CEO.

From the outside, BFI boundary conditions seemed beyond reproach. BFI was a publicly traded company. There was the requisite documentation of vision, mission, core values, treasury policies, and code of ethics—lengthy treatises authored by the CFO and general counsel. These documents were distributed together with over a hundred pages of financial and operational details. In practice, the board was never engaged in either the creation or a critical review. Their approval was passive and ultimately destructive.

BFI's board typically met six times a year. The agenda was tightly controlled by management and focused on extended discussion of financial and operational details. Boundary condition matters, if open for discussion at all, were scheduled late in the agenda. The rhetorical style was one of presentation rather than dialog, allowing for only the most perfunctory questions. By an unwritten agreement, homogeneity was highly valued and dissent was unacceptable. Discussion was severely limited by the legacy chairman. So boundary conditions in and of themselves are no guarantee of sound governance. They are only effective if the board and management earnestly negotiate over and agree upon them.

Rules of Engagement

Taken from the military and signifying the terms and conditions under which contact will take place, *rules of engagement* describe how an entity works together: how business is conducted, how members interact and difficult conversations are carried out, together with such matters as committee structures, decision protocols, control methods, and compliance mechanics. They are best developed against the backdrop of a few simple principles:

Governance is a form of ownership, not a branch of management. Trusteeship should be neither a cere-

It takes time for a board to find its voice on key issues, often multiple meetings over several weeks.

monial honor nor a compensatory gesture for staff deficits. Ownership, even of the emotional variety, promotes commitment to the best interests of the organization as a whole and is secured by rules of engagement that align the interests of the board with those of the enterprise. Interestingly, partners in the highest-performing private equity funds often spend 15 days a month with a company during the first 100 days after gaining control, not to “run the place” but to assess management, pull together a strategy, and set appropriate performance metrics.

The board speaks with one voice or not at all.

Healthy rules of engagement create dynamics in which everyone is involved in the authentic exploration of ideas, surfacing differences and misgivings, and participating with all the passion of their diverse perspectives. Integrity argues, though, that when a board directs, it does so as one body. Short-circuiting the development of a single board voice destroys the governance process. It takes time for a group to find its voice on key issues, often multiple meetings over several weeks. Directors should be mindful that control of the board agenda can at times be used by management to circumvent the development of one voice and must insist that adequate time and appropriate process be available to work on critical issues.

Trivial “board packages” generate trivial discussion. Boards are typically made up of direct-action types who will respond to the information they get. The burden of presenting relevant information resides with executive leadership. Rules of engagement that fail to promote a strategically informed board are an invitation to trouble, either because of their simplicity or excessive complexity. Boards must insist that board packages and agendas are timely, consistent in their format, and stripped of the chaff that distracts from key governance matters.

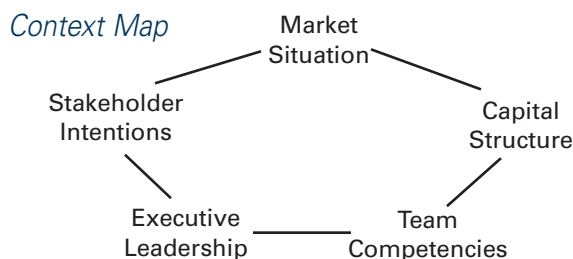
Boards need frank, unfiltered dialog. Rules of engagement must provide for open and frank discussion. This is typically the role of an effective chairman. Much has been made of “outside directors and chairman,” but the real test is whether the chairman promotes or smothers spirited dialog, rather than whether the chairman is an inside or outside director. An effective committee structure can also provide the checks and balances to ensure open dialog among directors.



The Context Map

Both boundary conditions and rules of engagement are developed for a particular context. In the final analysis, they are intended to ensure alignment between governance and fidelity to the interests of the market. A simple model representing the defining attributes of the context and the relationships among its parts appears to the right.

PCF had a growing dependence upon a market hooked on outsourcing. PCF also had a capital structure that constrained certain moves and had hired a CEO steeped in execution skills to lead a team of inwardly focused functional heads. Until the board mapped their total context and resolved its internal contradictions, the members were unable to separate their preferences and



prejudices from their business judgments. The map enabled them to see the source of their disagreements, especially the unspoken ones, while making the critical decisions needed for long-term success.

BFI boundary conditions appeared sound, but the rules of engagement that had been created by legacy shareholders constrained governance and ultimately drove out new members. The de facto context map, unaltered for nearly 15 years, centered almost entirely on the views and internal agendas of executive leadership. The board regularly received filtered information unaffected by the realities of the changing financial services industry.

Team competencies were ignored as the CEO and his staffers fired credit policy officers, merged all of the banks within the holding company into a single charter, made major portfolio changes without effective understanding or dialogue with the board, and arranged in excess of \$15 million of severance for themselves.

Stakeholder intentions were ignored as the stock price deteriorated. The CEO survived a no-confidence vote of the board by a razor-thin margin as several highly competent directors resigned. In the end, BFI was acquired in a strong equity market for banks at less than half its share price three years prior to the sale. One thousand employees were terminated for cost savings by the acquirer, and the communities where they worked suffered as functions were transferred to the acquirer.

As these examples illustrate, the quality of a board and the manner in which it governs is hugely influential with respect to the fate of a firm. The chart below outlines these cases and the relative robustness of each tool, in an assessment of their collective capacity to create shareholder value.

| | Boundary Conditions | Rules of Engagement | Context Map | Outcome |
|-----|---------------------|---------------------|-------------|----------------|
| BFI | Strong | Weak | Very Weak | Value Eroded |
| PCF | Strong | Improving | Strong | Value Building |

Writing the "Next Chapter" for Your Board

Putting these frameworks into practice is not a linear process. Reality has a way of forcing us to go back over ground we thought we'd covered. There is, though, an effective order in which directors can harness their

NACD Corporate Board Members Respond to Hurricane Katrina

BC/BS of Louisiana. Created Hurricane Katrina support website (<http://www.bcbsla.com/web/Katrina/default.asp>); is running television spots giving instructions on receiving BC/BS assistance; has a hotline for customers affected by Katrina, 1.800.599.2583; is allowing extra time to pay premiums, early prescription refills, and access to all doctors including those outside of BC/BS network; distributed US HHS counseling hotline number 1.800.273.TALK.

CenturyTel, Inc. Installed a 56-seat call center (in four hours) in the United Way of NE Louisiana office in Monroe, Louisiana; is working with wireless carriers to make emergency call center accessible throughout the state from cellular phones; made an initial \$50,000 contribution to the American Red Cross and will match employee contributions up to another \$50,000; is distributing more than 40,000 prepaid calling cards to displaced victims; is encouraging employees to donate blood; and has links to the American Red Cross www.centurytel.com.

LAMMICO. Established FAQs on website to educate its physician subscribers on coverage for treating victims; and extended coverage past renewal dates.

LHC Group. Initiated a hotline service for elderly or disabled patients displaced or relocated because of Hurricane Katrina, with healthcare assistance 877-386-3086; and is offering healthcare professionals who have been affected by the disaster help in finding employment.

The Shaw Group. Matching employee contributions; encouraging employees to give food and clothing and donate blood; and providing housing assistance for displaced residents.



capacity to facilitate their development as a more effective board. Think of the process as consisting of four sessions, spread out or collapsed as appropriate. Approach it with the kind of pre-work that will inform the conversations that need to take place.

Session One: Map the Context

Begin with the outside. Specifically, the context map will take four key dimensions into consideration:

- Market dynamics: demand factors, competitive dynamics.
- Capital structure: limitations imposed by how the company is held.
- Stakeholder attributes: hopes, dreams, and deficits of the board.
- CEO/team characteristics: propensities and vulnerabilities.

Session Two: Establish the Boundary Conditions.

Define the limits of executive discretion by “roping off” the leadership arena.

- Legal and ethical considerations: values and governmental constraints.
- Stakeholder aspirations: what does “success” mean for ownership?
- Working hypothesis on strategy: value proposition and “game plan.”
- Risk management directives: key tradeoffs and basic policies.

Session Three: Clarify the Rules of Engagement

- Living the principles: adaptation of the “foundational five.”
- Setting the ground rules: information flows, decision protocols.
- Structuring the committees: what’s required; what’s strategic.

Session Four: Develop the Work Agenda

The first round of sessions will set the stage for planning two concurrent streams of activity into the future.

- The first should be structuring a standing agenda for the board that combines tool maintenance with performance management.
- The second will be creating a fact-based plan for the further development of the board.

Conclusion

Governing boards must continuously develop the competence of their members, the diversity of their membership, and their capacity to function with candor, openness, and reflection. As with all groups, this seldom

happens on its own and never improves with the mere passage of time. Indeed, the case for board development can best be prosecuted with systematic interventions at the individual, collective, and structural levels. A set of operationally useful boundary conditions, informed by a dynamic map of the content, and managed according to comprehensive and internally consistent rules of engagement, can lend much-needed discipline to the process. ■

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Directions with Mark Goulston

The Right Attitude

Gratitude is the key to the right attitude. First, you’re grateful that you had the opportunity to work, learn, and observe from someone for whom you have so much respect. That respect and gratitude causes you to reflect upon any important decision, and to ask yourself “how would he or she react in this situation?” Most likely that question will guide you in the search for the right answer. By making the correct choice and doing the right thing you honor your mentor.

—Jim Sinegal, President and CEO, Costco

Jim Sinegal’s pedigree is not from the Ivy League. He came up from the junior college circuit. He thinks of himself as a former “juvenile delinquent” and may have headed in a less productive direction were it not for his good fortune to have Sol Price as a mentor. Price pioneered the warehouse retail store concept with Price Club and Sinegal learned more than how to run a company from him. He learned how to value everyone a company touches—from customers to employees to vendors to shareholders. Sinegal learned that if you learn to take advantage of opportunity, you don’t have to take advantage of people. In 1995 Costco purchased Price Club and the “do well by doing good” spirit of Sol Price lives on through Jim Sinegal, who has served as a director on the Costco board since its founding.

Mark Goulston, M.D., is an advisor to boards, speaks at retreats, and interviews directors on their guiding principles. He is the author of *Get Out of Your Own Way at Work and Help Others Do the Same* (Putnam: 2005). He may be contacted at mgoulston@markgoulston.com.