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Board Transformation: Does Change Have A Chance?

By Michael L. Noël and C. Thomas Dortch

Good old "fear of change" is a powerful driver. In many cases, becoming an involved, engaged board requires a fundamental shift in thinking. It may force a passive, "sweetheart" board to break its existing routine and discard the notion that "we've always done it that way." Uncomfortable, to say the least. But we have to ask ourselves: "What is the alternative?"

Becoming an engaged board is a journey, aided by tools such as self-assessments. But the first step on this journey is something much more basic: confronting the resistance.

Fear of Losing Membership

Look at the composition of many boards and you'll find friends of the CEO, family members, and prominent individuals in the community who are business or social acquaintances. These relationships don't dissolve within the walls of the boardroom—and too many directors know this firsthand. Because of these tight-knit connections, accurate descriptions and debates about difficult issues may never take place, if they're raised at all.

These board relationships—and the values, ethics, and motivations of each board member—are the essence of the board's "culture." And depending on the members, this culture can be highly resistant to change. To shift to a new level of performance, *all* board members must commit to the necessary changes, demands, and effort. A tall order, to say the least. Complicating matters, change can sometimes erode the business or social relationships that extend beyond the boardroom. Many see this as a risk not worth taking.

Director Summary: A board self-assessment is often low on the priority list for directors. And there are several perceived reasons for the reluctance—many of them unfounded. But by embracing a self-assessment, boards can begin making changes that are long overdue, and critical to future success.

Fear of Open, Personal Relationships

A change in board *culture* is a necessary precursor to a change in board governance. But board members are often task-focused individuals; activities such as strategic retreats, lengthy open discussions, and formal board evaluations are often considered not as important as tending to "business issues."

This view couldn't be more erroneous. In fact, retreats, evaluations, and broad discussions are vital to the change process. They foster candor, trust, respect, and a team approach that is too often not witnessed in the boardroom.

Fear of Losing Compensation

Many board members reap tremendous financial rewards from their affiliation with the board. Retainers, perks, and business opportunities can represent a critical component of a board member's personal compensation. Naturally, board members will tend to resist any change that may affect their board relationships and, by extension, their compensation.

The "L" Word

Among many board members, the notion of board evaluations triggers a major concern: legal liability. After all, we are a litigious society, and it seems as though some shareholders are ready to sue at the drop of a hat.

Too often, fear of litigation is used as a reason for not performing assessments of board performance. Board members shudder at the thought of a critical evaluation finding its way into a lawsuit, or even instigating a suit. However, much of this fear stems from a misunderstanding of the evaluation process itself. Board members often envision an outside consultant stepping in to deliver a report that details the board's shortcomings, and outlines cumbersome improvements that the board must address.

With meaningful feedback as a guide, boards are able develop strategies and goals that make sense for their own situations.

In reality, the process can be highly customized—and conducted in a way that is mindful of litigation concerns. After all, experienced consultants understand the risk of legal liability. They can work within the company's and directors' legal framework.

When executed correctly, the assessment process is actually *beneficial* from a legal standpoint. It demonstrates that board members are taking reasonable and prudent action to improve the communication, functioning, and logistics of the board. And it stands as written proof that the board is taking action in the best interest of shareholders.

Who Has the Time?

Given all the fear around change and litigation, is it any wonder that many boards see self-assessment as an added burden—a time-consuming and potentially non-productive exercise?

Any type of assessment—and resulting change—takes time. Time to assess, time to review the results, and time to develop action plans and see them through. Effort is required of each board member, and schedules are already tight.

"Who has the time?" some board members ask, bewildered. But this mentality is shortsighted. For how much time is wasted when dysfunction grips a board, when meetings drag on with no result, and when companies are led astray by lackadaisical board governance?

The Carrot and the Stick

True transformation occurs only when the entire board agrees that the *rewards* for changing—or the consequences for not changing—outweigh the collective fear. This is where the change process begins.

Realizing the reward. We all seek rewards tied to our values, ethics, and motivations. And smart companies and boards will evaluate these personal characteristics—as well as knowledge, skills, and connections—when deciding who is worthy of a board position.

Board members who are motivated by change and by providing true value to management and shareholders will approach board governance in an open and trusting manner. They are eager to make changes that will improve board performance, and they will commit the time and effort necessary.

On the flip side, board members who are more interested in their own gain will steel themselves against any sort of change that threatens the status quo. And they will hold on with a white-knuckle grip. Unfortunately, when this stalemate is reached, there is usually only one action that works: the board member must be replaced.

Consequences ahead. Lax enforcement of existing regulations, combined with shareholder apathy, have contributed to recent corporate misdeeds. But the landscape is changing rapidly, and Securities and Exchange Commission (SEC) proposals are paving the way for more open and involved boards.

Debate about the consequences of poor board performance is moving outside boardrooms and corporate leadership circles. Shareholders have begun to press for rights they believe they own—a trend that is especially true of large shareholder groups (think Disney). Taken together, the enforcement of current and new regulations, as well as increased involvement of shareholders, will drive more accountability at the board level.

Building an Engaged Board

Just what does an engaged board look like? Among other duties, it:

- Actively defines its roles and boundaries.
- Conducts substantive discussions on key issues.
- Provides insight, advice, and support on key strategies and decisions.
- Exercises its responsibility for overseeing CEO and company performance.
- Creates an open forum of intellectually honest dialogue and, if necessary, debate.

The million-dollar question, of course, is *how to get from here to there*; how to move from passive to active. Again, we return to the evaluation tool. A written annual board evaluation not only generates meaningful dialogue, it serves as a clear road map to set and achieve realistic goals.

Unfortunately, even some boards that *do* conduct a regular self-assessment don't appear to use it as an improvement tool. According to a survey by the Center for Effective Organizations, the University of Southern California, and Mercer Delta, 56 percent of respondents said their board's performance is formally evaluated on a regular basis. However, just 16 percent had a plan to address the opportunities for improvement identified by the assessment.

Part of the problem may be that the recommendations are too vague or too cumbersome. Experienced assessment firms will be mindful of the recommendations they make. They will understand that the evaluation should start at a basic level—with targeted suggestions and a practical action plan.

In addition, for the evaluation to work, it must have some *written* component. It's too easy to forget verbal evaluations—particularly given other demands on directors' time.

The majority of shareholders would agree that written evaluations are a worthy exercise—and the SEC recommends that boards "perform an evaluation, at least annually, of the effectiveness of the board and its committees." For mutual fund boards, this isn't just a recommendation, it's a requirement—and the same may be true for other boards in the future.

Does Change Have A Chance?

It is naïve to think that most boards will suddenly embrace change. Yes, the boards that truly want to fulfill their responsibilities will work hard at improvement; but the rest will allow inertia to maintain the status quo, unless forced to act. However, with more investor involvement, sharper SEC oversight, and a public that's fed up with scandal, perhaps long-term change does have a chance. The key is making sure the right change occurs. As author Jeffery A. Sonnenfeld wrote in 2002:

> We'll be fighting the wrong war if we simply tighten procedural rules for boards and ignore their more pressing need—to be strong, high-functioning work groups whose members trust and challenge one another and engage directly with senior managers on critical issues facing corporations.

Implementing board self-assessments can keep us from "fighting the wrong war." With meaningful feedback as a guide, boards are able develop strategies and goals that make sense for their own situations. They can create plans that will help them clear their unique hurdles and achieve a greater level of effectiveness and engagement.

Socrates said that, "the unexamined life may not be worth living." By the same token, isn't the unexamined board also, in many ways, wasteful? In some cases it can be harmful, when boards fail to take responsible action.

Board self-assessments aren't a silver bullet—but they are an effective starting point that can deliver significant return. And there is growing awareness of the benefits self-assessments can deliver.

Change isn't easy. And it can induce fear. But given the history of board performance, isn't maintaining the status quo the most frightening option of all? ■

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Snapshot of the Assessment Process

While self-assessments may differ from one situation to another, typically the process includes these steps:

Step 1. The consultant or firm coordinating the self-assessment will share the survey questions with appropriate members of the board, such as those on the governance committee and the chairman of the board. The questions are customized if needed.

Step 2. Each board member completes the survey. Answers are kept confidential.

Step 3. The consultant may conduct a short phone call or face-to-face meeting with board members to gather additional feedback about board performance. Again, all information is confidential.

Step 4. The data is analyzed and organized into a final report. The level of detail is customized to the needs of the board. The report can review overall board performance, committee performance and even individual board member performance, if requested. The data may also be compared to prior years if the assessment is annual, enabling the measurement of progress. It is customary to phrase statements to protect individual board member identities. Again, confidentiality is paramount.

Step 5. The report is presented to the board, along with recommendations. If appropriate, one-on-one discussions are held with board members. The information is then folded into the board's strategic action plan for continuous improvement.

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