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# Stop the Insanity

The Brown Governance Newsletter: April 2015

**This edition of Brown Governance's newsletter is devoted to exploring the subject of a troubling trend we are seeing in a lot of boardrooms today.**

Our readers will know that normally our newsletters are designed to be positive and helpful and provide you with up to date research and advice on topics related to governance. While this current edition includes those elements, we are troubled by some trends that we are seeing, and feel compelled to shine light on and ask you to reflect on them.

More and more we are becoming troubled as boards are straying from accepted and proven governance practices by engaging in activities that end up having the opposite than intended effect, damaging organizational effectiveness and burning through really good CEOs.

## What are we seeing?

Here are some of the trending activities that are troubling:

- ***Consistent violations of the board/management line with staff:*** Board members going to see managers one or several levels below the CEO, to "find out what's going on", asking and talking about substantive matters directly with them, often without any warning or notice to others;

- ***Improper communication protocols:*** Board members sending e-mails between board meetings, not only to one another, but often copying several or even dozens of people in the organization, ending up with chains of questions, comments and suggestions about board matters;

- ***Improper use of in-camera and executive sessions:*** Boards and Committees holding long in camera sessions at both the beginning and end of each meeting, without the CEO or any staff present, often lasting 45 minutes or more;

- ***Boards having multiple VP's reporting to them:*** Boards insisting on making the hiring decision on Vice-Presidents, on setting their compensation, on approving their performance evaluations, salary increases and bonuses, essentially turning these positions into direct reports of the Board, not the CEO;

- ***Board Chairs usurping the CEO:*** Board Chairs keeping offices and dedicated staff at the company's head office, coming in "to work" almost every day, acting like the head of the organization;

- ***Individual Directors instructing staff:*** Boards or board members giving direction to staff on operational matters – "here's what you need to do";

- ***Boards attempting to manage organization's risk and allocate resources:*** Boards setting the "top 5" or "top 10" risks of the organization (using coloured dots on wall charts, or cool real-time voting buttons), then using these to have management allocate scarce resources to them as priorities; and even

- ***Boards excluding management from strategy:*** Boards holding strategy retreats without management present, in whole or large part.

## Why are these troubling?

You've probably heard the nautical analogy that "the board steers the boat – management rows the boat". The point is that when boards decide to get into the weeds or the kitchen and do management's job, this results in several negative consequences:

- If you are rowing the boat, who is steering it? If board members are directing operational activities, who is setting the strategic direction? Sure, you can try to multi-task, but as soon as a board member starts to author operational tactics, they lose the independence needed to effectively govern. That's why we don't have auditors write policies or design controls. The ability to think and act independently of management is central to effective board governance.

- When board members direct operational activities, they deny the organization the benefit of management's industry and technical expertise. Very few board members will ever understand the industry and business as well as management do. So why would we invite board members to identify the top risks, to decide on allocation of resources, to tell VP's and Directors what they should be working on or how they should be doing their job? If you, as a board member, really do know more about the business than your top executives, you probably should quit the board and get hired as a top executive, why not get paid for your brilliance?

- Board members may not intend to give instructions to staff when they have informal meetings with them, the board member may really just want to learn more about how the company works. But if you are a branch manager or a business unit manager several levels removed from the CEO, and a board member says to you, "Why don't you do it this way instead?", don't be surprised if what they hear is, "Do it this way instead!"

- Even if it's a good idea (which it often is *not*), it has not been routed through the Board or CEO, so staff, capital and facilities are being redirected without benefit of proper review, assessment, fit with strategy or approval.

- When board members make decisions without being in a formally constituted board meeting, with notice and quorum, they are not only acting outside their legal authority, they are subverting the process and excluding other board members and executives from due deliberation. You are not hearing divergent perspectives, the "stakeholder voices" that are absolutely essential before exercising "fiduciary vote".

- When board members meet without the CEO to discuss substantive items, they rob the company of the benefit of the CEO's knowledge, research, expertise and insights. We have seen boards that hold in camera sessions the night before or the morning of the board meeting, and end up making all the substantial decisions on the agenda before the CEO is even invited to join the meeting.

- When the Board starts dealing with VP's as direct hires and employees of the Board, there are huge negative consequences:

    - The CEO's authority is diminished and usurped – you have sent a signal that the Board does not have complete confidence in the CEO.

    - As a result, the CEO cannot really be held accountable for consequences of Board decisions – the board hired the VP and he/she isn't working out, that's now the Board's problem to deal with, not the CEO's – you have created divided leadership at the top of the company.

- The VP now feels that their accountability is to the Board, and they are now tempted to go around the CEO, especially on sensitive matters or when they are not getting what they want from the CEO. This creates a web of authority, communication and accountability relationships, dissipates effort and energy, leading to waste, division, camps or cliques, and impaired organizational effectiveness.

- The same things happen when the Chair sets up an office and staff on the executive floor.

- The Board doesn't have either the time or the capacity to be the Senior Management Committee of the company – but that's what you're setting yourself up for.

All of these governance activities may seem innocuous at first and in isolation, but in board after board, we are seeing that after a couple of years, the relationship between the board and CEO sours, really good CEO's won't take it, so move on, or the board fires them. Sure, you may be able to attract another good CEO once, but after a while, the word is out, this is a hands-on board, it does not respect the red line between the board and CEO, it likes to manage and not to govern.

The ultimate consequence of these troubling trends is lowering the "leadership lid" that John Maxwell talks about. The potential and performance of the organization drops lower and lower, the high potential people leave, and a mediocre CEO or someone nearing their retirement takes on the job, lets the board run the shop, and puts it on "cruise". As the leadership level shrinks, so too does the organization.

## Why are these happening?

There are a number of contributing factors to these trends, but more often than not it comes down to inexperienced board members being instructed and guided by inexperienced, even misinformed, advisors.

We have people teaching national director education programs who have no experience on either side of the boardroom table, and who cannot even begin to describe the differences between reform governance and either of its predecessors, policy governance or traditional board governance.

We have so called governance “professionals” who have never been a CEO or even have any experience working as an executive or senior manager in industry or the business world.  These aren’t just individual corporate-types who retire and hang out a shingle as a self-proclaimed “Governance Expert”, these are even the consultants you get from more than one of the big 4 global accounting professional services firms.

These folks are teaching new board members governance practices that they think might be a good idea.  “You should be ‘generative’ and not just fiduciary.”  “You should be ‘disruptive’ and not just independent.”  “You need to get out into the field and kick the tires.”  “You need to question the CEO’s competence and integrity.”  “You need to meet just with the board members to truly be independent.”  “You need to spend time with the staff and get to know them.”  “You need to … [fill in the blanks with whatever you like!]”

We also have inexperienced people being appointed to boards, using criteria such as forced diversity quotas and satisfying self-interested segments of the ownership, membership or stakeholders to trump industry experience, business and governance skills.  There is nothing like a few experienced CEO’s and other senior business executives on a board.  Don’t get us wrong, we are huge supporters of diversity on boards, in all its forms, but that is no reason to sacrifice core experience and functional skills.

And we had the 2008 scare in the financial services sector which regulators and other governance thought influencers have used as an excuse to introduce untried and untested, often counter-productive, governance practices and ideas. It's like Sarbanes-Oxley all over again, but this time without the counter-weight of the SEC, stock exchanges and capital markets to temper shotgun solutions.

## What should we do about it?

Stop the insanity!

Stick to your knitting. Understand and practice the fundamental principles and practices of reform governance, as articulated by Cadbury, Dey, King and others.

1. The board has one employee, the CEO. The board governs – setting strategic direction, hiring the CEO, and overseeing performance to gain reasonable assurance. The CEO manages – casting and executing strategy, hiring and overseeing everyone else, and being accountable for corporate performance to the board.

2. There are a handful of senior positions that we call "internal control officers", such as the CFO, Internal Audit Executive, Corporate Secretary, CRO and CCO. Part of their job is operational, which is the CEO's purview, but part of their job is internal control, that is it is part of the Board's governance (oversight) function. The proper way to handle this is to create a dotted line accountability from these positions to the Board (or applicable Committee) for the internal control/governance part of their job. That will include the Board or Committee having a say in their mandate/work plan and resources, and will include brief in camera sessions with each on a regular basis – to gain independent assurance that there are no constraints imposed by the CEO or others on their capacity to execute their mandates fully, not to start up gossip about the CEO or micro-manage the company through these people, to go around the CEO. The CEO

will often bring the final candidate for each position to the Board or Committee Chair before hiring them, to gain a “one-up” check on the CEO’s final hiring decision, but not to take the hiring decision away from the CEO. The Board does have input, even approval, of executive compensation design, especially incentive design, but not setting the pay of employees beyond the CEO.

3. There are legitimate purposes for in camera sessions (properly called executive sessions). Most of these will include the CEO in the room – when you are dealing with sensitive, HR or legal matters, for example, or framing the meeting at the beginning. The best Boards rotate other VP’s through their meetings for applicable agenda items, but the CEO stays for all agenda items. The Board would ask the CEO to leave, and hold a brief executive session at the very end of the meeting, but there should only be two topics on the agenda – the CEO’s own employment/performance, and internal board discipline matters. If you see the conversation moving off these topics, stop it and/or bring the CEO back in.

4. Agree on and put in place a clear Communications Protocol that deals with board members communicating with one another and with staff between meetings. Board and Committee Chairs will have specific needs to communicate with responsible executives on agenda matters. New board members will have needs for orientation and training, and board members may legitimately seek exposure to field sites. But the general principle is that board members’ communications and engagement with staff, and with each other, should go through the Board Chair and CEO. In some places, this means channelling everything through them, in other places, the protocol is to cc the Chair and CEO. But agree on a protocol, for face-to-face

and electronic communications, and stick to it – enforce it.

5. There is a line between the Board and CEO, and it exists for very good and proven reasons. Where and how you draw it will vary from company to company and from time to time, but once it's drawn, respect it.

6. Finally, beware of governance professionals, whether director education programs or board governance consultants. They are not all bad, but they are not all good either! This is still a young discipline, and it is completely unregulated. It is an increasingly crowded field, and you can't tell the book by its cover. Many of the leading national director education program instructors, and governance consultants, have no idea what reform governance is, why we need it, and why to stick with it.

Don't let your boardroom be turned into an uncontrolled lab experiment … "hey, why don't we try this!" or "I was taught or told to do this!"

Of course we believe that the **Professional Director Education and Certification Program** will educate your board members in the proper manner of reform governance, and that **Brown Governance** will deal with your board and governance effectiveness with wisdom and tact.

Take a hard look at Director Education programs and governance professionals. Don't just look at their credentials, talk to their clients. You wouldn't hire an employee or board member without references, dig into these choices.

And if you are the CEO with a board that's heading down this troubling road, negotiate a good severance package and brush off your resume, in case you are not able to get them to "stop the insanity!"

## The Professional Director Education & Certification Program

To learn more about Director Education that will help "stop the insanity" go to www.professionaldirector.com

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