The Future of Boards

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Jay W.Lorsch (Ed.) (2012). The Future of Boards. HBR Press, Boston, Price Rs.1250, Pages: 193, ISBN: 9781422183212.

Professor Jay Lorsch, an accomplished expert on board processes and corporate governance, has taken initiative to assemble together an array of luminaries to produce a wonderful book, *The Future of Boards*, on corporate governance and board processes in the changed context of today and argues about how boards will look and behave in future.

The book is a collection of eight well-thought out articles on various subjects related to board processes and governance. In Chapter 1, Lorsch writes about the board room challenges in the backdrop of the financial crisis in the period 2007-09. According to him, the problems of the recent crisis were different from those of 2002 and feels that the failure of corporate governance in the financial crisis had more to do with the growing complexity of companies that boards have to govern now. The important difficulty is that the laws and regulations today require the directors to pass the test of independence which makes it difficult for a director to have a complete understanding of the business. To be conversant with the business, directors have to depend a lot on management, which can frustrate them. His research conducted among directors led to the solution of having lead directors than separating the chair and CEO positions.

Lorsch then discusses the research findings about board's involvement in various activities such as strategy, management succession and development, risk management. He concludes the chapter with the research findings on suggestions for making boards more effective.

The second chapter by Krishna Palepu describes the common frustrations among directors about their insufficient engagement in strategic issues and business risks their companies are facing. He then identifies the challenges or barriers that directors face in the board room in regard to strategy. According to him, the four barriers are (1) lack of role clarity, (2) lack of strategic focus on board agendas, (3) lack of strategic information and (4) dysfunctional boardroom dynamics. Finally he suggests two major steps with four questions to be asked under step 1 and two sub-steps under step 2 to create a framework for board engagement in strategy.

Step1: Understanding Strategy: What does the customer we are targeting need and what is our proposed solution? Who are our competitors and how do we win against them? What do we need to do to make our strategy sustainable? What is the game plan for sustaining our competitive advantage or for strategic renewal? Step 2: Including a strategic information brief in every board book and using the regular board meetings to update on strategic issues.

In chapter three, Joseph L. Bower discusses the challenges boards face in CEO succession. After enumerating the recent research findings on the relationship between management, CEO and the board, he describes the CEO job, how to develop CEO candidates, how a board makes the succession choice etc. He then describes the two possible scenarios, from incumbent to insider and from incumbent to outsider CEO. He explains how Jeff Immelt grew within GE to succeed Jack Welch in 2001. Bower also explains the role of the board in the CEO succession:

1. Understand how much work has to be carried out by the CEO and his top team; when to initiate the process and how to get the entire company focused on leadership development.
2. Help the CEO to focus on the succession challenges.
3. Establish a process to identify a pool of CEO candidates with an emphasis on what Bower calls "inside-outsiders", who have performed well and risen high but have maintained their objectivity - independent minds, high integrity, knowledge about changes needed and familiarity with the organization, its culture, and people.
4. Prune the list to a few best ones.
5. Make the final choice.
6. Manage the transition.

In the next chapter, Lorsch and Rakesh Khurana discuss one of the most important themes of corporate governance today- the executive compensation. The theme assumes importance since a number of observers put the blame on the flawed compensation policies for the recent economic melt-down. The problem is more acute in the US compared to other countries. Lorsch & Khurana present an array of statistics to prove their points. Lorsch and Khurana have chosen to disagree with the premises underlying the remedies suggested by experts like increasing the independence of the directors and compensation committees, increasing the shareholders' rights to express their views on compensation plans, aligning the incentives more closely with owners. The authors identify the complexity of the corporations leading to the emergence of compensation consultants to advise boards on compensation policies, the flawed assumption that monetary rewards are the more important motivating factor for the executives, the fallacious assumption that there exists a market for senior level executives, the agency theory etc., as the contributing reasons. The solution to the problem lies in creating a larger and more public discussion about the purpose of the corporation, and even larger moral and political considerations.

In chapter five Bill George argues that one's perspective about board's governance is strongly influenced by the perspectives developed from the seat occupied by an independent director, chair, chair and CEO, CEO only, chair only, or someone who believes in governance but has never served on a major board.

If one is an independent director, he has to meet the rising expectations, thanks to the new board & governance (since governance related regulations always need not be direct government regulations, governance regulations will be a better word) regulations in most parts of the world. The major challenge for them is to keep themselves fully informed about the company on whose boards they serve while only attending about six to eight board meetings a year or sometimes more frequently if they serve on some committees too. Given such limitations, George suggests four principal areas for independent directors to contribute: Offering sound judgment and asking the right questions to management; Being an advocate of sound board governance; Helping to ensure the effectiveness of the company's leadership team, and its leadership succession plans and Taking on leadership roles in crises.

In a case where there is a separate non-executive chair, the effectiveness of the structure depends on the relationship between the two individuals. If they are not in agreement about the direction of the company, leadership, strategy etc, an unhealthy conflict may emerge which may affect the very direction of the company. At times, the two leaders may engage in a power struggle leading to detrimental effects on the board, management and the company. The dual role of Chair & CEO, according to George, is to avoid any likelihood of conflicts or power struggles within the board room. And George asserts that with the majority independent directors on boards, usually with a designated lead director, there is no chance of any power concentration in the Chair and the CEO.

When former CEOs become chair, there is a likelihood that they may have a tendency to overshadow or even override the CEO. George concludes by giving three observations: There is no one structure that fits all companies. The board should be pragmatic to adopt a structure that works well; CEOs and board members must appreciate that one's perspective comes from one's position; All boards should encourage their CEOs to become independent director in another company to understand the challenges independent directors face.

Chapter six by Katharina Pick and Kenneth Merchant talks about the various negative board-room dynamics or pathologies that can undermine a board's ability to provide effective oversight. The authors discuss six types of inherent tensions in the functioning of boards as a group: 1.The Social-Cohesion tension: The forces that bind a group of individuals together and keep members wanting to be part of the group. Strong social cohesion allows the board to function smoothly, but a risk of greater pressure for members to conform to the majority's point of view. 2. The Dissension tension: The degree to which dissent should be allowed to exist or even be encouraged, which is essential to avoid conformity. 3. The Psychological-Safety tension: The shared belief that the group is a safe place for risk taking, sharing unpopular ideas and admitting errors, not only enables members to speak up, ask questions and admit mistakes but helps to counteract conformity pressures and groupthink, but too much can lead to social loafing. 4. The Collectivist-Feelings tension: Boards need to have a sense of being in a group. But, when collectivist feeling begins to override the need for dissent, the conformity issues may crop up. 5. The Diversity-of-Thought tension: The more diverse the board is, the less likely it is to be highly socially cohesive, leading to less conformity and more dissent. But, risk is less shared information among group members. 6. The Strong Leader tension: The tension related to board leadership. The board leader, chair or lead director, has important roles to play- not only lead the board activities but also create the meeting norms and culture, set the agenda and frame issues appropriately. They must encourage individual directors to contribute, but be firm about timewasters.

When the tensions discussed above are not acknowledged or balanced, eight negative dynamics or pathologies may emerge. These are: (1) Excessive conformity, (2) Negative group conflict, (3) Politicking and dysfunctional coalition formation (4) Habitual routines (5) Shared information bias, (6) Pluralistic ignorance (7) Social loafing and (8) Group polarization. The authors conclude by narrating how to manage the tensions.

In chapter seven, David Nadler puts forth his arguments for a separate chair. The reasons enumerated by him are: (1) The board has a real work to do and that work has to be managed. Separation of the roles enables the chair to fully dedicate to board work. (2) A separate board leader can better manage the performance of the individual directors as s/he is not constrained by factors that a CEO usually is. (3) A separate leader can act as a sounding board for the CEO, enabling the CEO to stay connected without having to deal with the entire board.

(4) The independent board leader can provide an early warning system when something goes off- track. (5) A separate leadership for the board can enable the board to act independently in times of need like an issue involving the CEO arises.

Nadler describes the characteristics of the right person to assume the board leadership: Business acumen, Credibility, Interpersonal skills, Leadership skills, Appropriate motivation and Compatibility with the CEO. Nadler feels that the lead director proposition has more disadvantages than advantages. With the non-executive or executive chair, there may arise an ambiguity about board leadership. Also, lead director has less stature and legitimacy to function externally and may not be able to represent the company.

The last chapter by Raymond Gilmartin, provides arguments in support of a lead director. He feels that there is a need for an independent board leadership especially when the Chair is also the CEO. Gilmartin then discusses the roles and responsibilities of the lead director: develop board agendas with the chair and CEO, advise the chair and CEO on quality, quantity and timeliness of information from management, act as the principal liaison between the independent directors and the chair & CEO, preside executive sessions of the independent directors with chair and CEO not present, communicate the outcomes of the executive sessions to the Chair and theCEO, serve as a spokesperson for the board when Chair and CEO are not present. The author concludes by comparing the Non-executive Chair with lead director, and asserts that the lead director concept is superior to separating the roles of the Chair and CEO.

The book is a wonderful collection of ideas from some of the best minds on the subject of boards and corporate governance. A refreshing change from the conventional approach to corporate governance from the financial implications of corporate governance to the more appropriate behaviours of the board, underscoring the important message: corporate governance can't be reduced to a set of numbers and statistics. And that corporate governance is fundamentally required because the interests or purpose of the corporation has to be protected has been emphasized. Barring a few editing errors (for example, Pick and Merchant talk about nine pathologies but only eight are listed in the book), the book is a must read for everybody interested in boards and good corporate governance.

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