



KORN/FERRY INTERNATIONAL

## BOARD MEETING IN SESSION

Twenty “Best Practices”  
To Improve  
Board Performance

In Conjunction with  
Center for Effective Organizations and The Leadership Institute  
The University of Southern California



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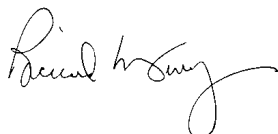
# Twenty “Best Practices” To Improve Board Performance

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**F**or over 25 years, Korn/Ferry International has been monitoring and reporting on the changes that are occurring in the boardrooms of Corporate America. Recently, we have been witness to “a quiet revolution,” as boards become more active, take more responsibility and accept more accountability for the overall governance and sustained performance of the corporation.

Against this backdrop, we felt that the time was right to define more formally “best practices” that companies might adopt to speed up the evolutionary changes we are seeing today. Working with the University of Southern California’s Center for Effective Organizations and The Leadership Institute, we drew on our combined knowledge of the boardroom – based on numerous discussions with CEOs and directors and on Korn/Ferry’s own benchmark study on board governance, now in its twenty-third year. The result is the “best practices” you see here.

Some of these are radical in nature – representing a look to the future of boardroom activity – and not all of these would be practical for every company. Our intention here is to encourage boards to take a fresh look at how they are operating – and to continue to improve their effectiveness as the legal overseers of the corporation.



**Richard M. Ferry**  
**Chairman**

## Overview

There are five key areas that boards should focus on as they fulfill their responsibilities for overall governance and company performance.

### ■ ***Strategic direction and implementation.***

Fundamental to the operation of any business is its strategy. Boards are rarely in a position to create strategy, but they can give input and advice on the direction that the CEO and senior management team create for a corporation. Particularly when board members come from different backgrounds, countries, companies and types of organizations, they can share a wealth of information and serve as a reality check – providing outsiders' views on the strategy's effectiveness.

Since most strategies fail not because they are flawed in concept, but because they are poorly implemented, boards can play a critical role in evaluating how well the business strategy of the organization is being carried out. In the case of a poorly executed strategy, boards are often in the best position to determine whether a strategy is failing because it is inappropriate or because it is not being implemented correctly – and what to do about it. Ultimately, of course, the marketplace will make the final decision, but an alert board can anticipate problems.

### ■ ***Monitoring financial performance.***

One of the board's top priorities should be to monitor the financial performance of the company – making sure that net earnings, earnings per share and stock price and dividends are healthy, monitoring capital structure and the balance sheet, seeing that the right investments are made in the corporation's future growth and keeping an eye on the long-term value to shareholders.

### ■ ***CEO development, evaluation and succession.***

No one else in the organization or in the stakeholder community has the unique combination of the legal mandate, information about the

company and its executives, knowledge of other companies and the expertise needed to select, evaluate and develop a CEO. The board can help the CEO recognize needed areas of improvement and guide the CEO's continuing growth and development.

The board is also uniquely positioned to make sure that succession plans – for the CEO and other senior executives – are in place and are reviewed periodically to determine whether they are still viable and meet the goals of the organization.

■ ***Monitoring the legal and ethical performance of the corporation.***

Boards not only have access to information about ethical and legal behavior of an organization – they have the power to act if problems occur. They need to do a visible and proactive check on the way senior management and the corporation do business, looking for early warning signals before they become major problems.

■ ***Crisis management.***

In today's turbulent business times, corporations are frequently faced with unexpected crises and developments. These range from poor management performance to hostile takeovers to illness striking a key member of the senior executive team. Boards should devote a significant amount of time to monitoring the environment to try to anticipate potential threats – and ward off crises before they occur. Particularly in the case of crises involving senior management and major corporate financial transactions, boards are the only ones who are legally empowered to act – and must be prepared to do so swiftly and effectively.

## Keys to Effectiveness

Research on organizational and team effectiveness suggests that there are five attributes that any corporate team needs in order to be effective: expertise, information, power, motivation and focus. Here is how these may apply to the boardroom.

- **Expertise** – in such areas as business strategy, finance, government, technology, society and how organizations work internally.
- **Information** – about markets and customers, the business environment and the performance and activities of competitors.
- **Power** – to reach decisions about the key issues a company faces – and have them accepted and implemented by the members of the corporation.
- **Motivation** – to take an active interest, keep informed, spend time on corporate activities and, of course, make decisions that will contribute to organizational effectiveness.
- **Focus** – to prepare for the meeting beforehand, to deal with the key issues at the meeting and to follow up appropriately.

The absence of any one of these characteristics will impact the overall effectiveness of the board. Thus, in the case of boards, it is not enough to have a knowledgeable or highly motivated group of individuals; the directors must, in combination, form an effective, productive group that has the right expertise, information, power and motivation – plus the initiative to use them in ways that contribute to organizational effectiveness. Since no single board member can be expected to understand all aspects of a business, the board needs to combine a variety of skills.

## Twenty “Best Practices”

Here are 20 potential ways to improve board governance, identified through our continuing research and discussion on the issues.

- 1. In selecting boards, consider the expertise and knowledge of each director so that the board as a whole has the ability to understand the overall industry, provide corporate governance, contribute to the design and management of the organization and grasp the business of the organization.***

Because of the complexity of most businesses, it is impossible for any one person – or even a small number of individuals – to be familiar with all the issues that would come before a board. But boards must have the knowledge to discuss all these issues intelligently and offer guidance. This argues for building a board on the basis of the competencies and knowledge that each individual brings, so that the board as an entity represents the broad expertise needed.

The first step is to identify the key areas of required knowledge – including business strategy, executive development, technology, organizational design, change management, finance, government affairs, business law and international experience.

You may want to create an expertise matrix or chart to use in selecting new directors – with board members on one axis and the key knowledge areas on the other. This allows a board to quickly assess where it has gaps and to take this into consideration for future appointments.

- 2. Make sure the board has the proper balance of members.***

In choosing board members, consider having on the board at least one sitting or former CEO of a comparably sized corporation. This provides a “peer” for the CEO to talk with – someone who can provide a perspective that potentially integrates the knowledge areas represented by the other members of the board.

**ABC Company**  
 Sample Board of Directors' Skills Matrix

	<b>Director A</b>	<b>Director B</b>
<b>Strategic Planning</b>	<b>Some.</b> Previously participated in strategic planning during early career	<b>Some.</b> Particularly in terms of high tech.
<b>Organizational Design</b>	<b>Considerable.</b> Was part of restructuring company.	<b>Minimal.</b>
<b>Change Management</b>	<b>Minimal.</b> Always been with stable organizations.	<b>Considerable.</b> Currently involved in such a situation.
<b>Technology</b>	<b>Some.</b> Degree in engineering but not particularly active now.	<b>Extensive.</b> Heads up high tech company with operations in U.S. and abroad.
<b>Financial Control</b>	<b>Minimal.</b> Experience has been in marketing	<b>Considerable.</b> Once served as CFO
<b>Marketing</b>	<b>Moderate.</b> Heaviest in industrial products.	<b>Limited.</b> Mostly finance/control.
<b>Human Resources</b>	<b>Moderate.</b> Has reputation for developing people, but no technical HR experience.	<b>Some.</b> Has supervised HR function and has reputation for dealing well with personnel.
<b>Government Affairs</b>	<b>Some.</b> Once represented a company with interface to several reporting agencies.	<b>Considerable.</b> Once served in Washington and widely known politically.
<b>Leadership</b>	<b>Excellent.</b> Has built up two companies and is well respected.	<b>Strong.</b> Active in both corporate and community leadership.
<b>Teamwork</b>	<b>Excellent.</b> An industry icon.	<b>Excellent.</b> Known for developing a strong management team.
<b>International</b>	<b>Some.</b> Spent time in London early in career	<b>Excellent.</b> Has managed Asia/Pacific and European operations.

Also, it may be useful to have directors who understand the company's key stakeholders, investors, vendors, the public and the government. In certain European countries, for example, it is common to have a non-management employee or union representative on the board – and a small number of U.S. corporations are doing this as well. Particularly as employees own more stock in major corporations, it could make sense to have someone from the general workforce on the board – both as a representative of an important group of stakeholders and as a link from the board to the employee stockholder group, although some experienced directors and CEOs disagree.

Diversity in gender and ethnic minorities should be considered, too. According to the 1996 Korn/Ferry board study, 31 percent of the respondents believe they should include more women directors, 26 percent would like to see at least one more African-American director and 15 percent believe they should add more Asians and more Latinos.

Foreign nationals, too, bring valuable new perspectives to the organization, and 17 percent of the directors surveyed would include more foreign nationals on their boards. An alternative approach could be to form a small international advisory board of four or five, who can provide input on overseas strategies.

### **3     *Control the size of the board.***

In terms of board size, skill needs and group dynamics are determining factors. A good starting point is the skill matrix; obviously, the more diverse and complex the corporation, the more board members are likely to be needed. However, large groups of individuals are always difficult to manage and organize. “Small is better” – our study shows that the average board now contains 11 members, down somewhat from previous years.

**4. *Make sure to have a sufficient number of independent directors.***

Independent board members are more likely to make tough decisions about executive compensation, to look objectively at the evaluation and appointment of senior managers, to challenge new strategies and to deal with issues of malfeasance and subpar performance. You may want to consider having three-quarters of your directors be independent.

What constitutes an independent board member? At the very least, it is someone who is not a full-time employee of the corporation – and who does not have a family or close business relationship with members of senior management or the corporation. Another “test” of independence is to make sure that no outside directors are chosen by the CEO without strong input from other outside members of the board.

**5. *Expect board members to invest time in their board duties over and above meeting attendance.***

All too often, board members are on multiple boards and, as a result, simply cannot find the time to do their regular duties as a board member, much less respond in times of crisis when intensive focus is needed. Consider selecting some board members – such as recently retired and self-employed individuals – who have more flexibility in terms of time and limiting the number of boards a director can serve on. More and more frequently, directors’ board memberships are re-examined when their employment situation changes, since they may no longer bring to the board the prestige or visibility that led to their original appointment or have the time to spend on board matters.

Respondents to Korn/Ferry’s board study believe directors should serve on no more than an average of two to three boards, although circumstances can vary depending on the frequency of meetings, committee workload, the capacity of the individual, etc.

**6** *Provide learning opportunities that focus on the competitive, technological, organizational and financial challenges the company faces.*

It may be necessary to bring board members up-to-speed on the key technologies of the organization, what its competitors are doing and how it measures its performance – perhaps providing new board members with a tutorial on the corporation and its business challenges. Then, on an ongoing basis, members should have opportunities to stay current on the business – through plant tours, for example, and presentations by senior management. The key is to bring all members of the board to a minimum level of knowledge about the major issues that they are likely to face as board members.

Board members might also benefit from in-house training programs or even selected development programs held at universities or by consulting firms, paid for by the company.

**7** *Counsel the board on developing group process and decision-making skills.*

Group decision-making is an extremely complex activity – particularly difficult when individuals with different backgrounds and perspectives spend only a few hours together and are then expected to make very complex decisions.

Boards should spend some time on a regular basis focusing on how they want to operate in terms of decision-making, group discussion and interpersonal relations. This could take the form of at least once-a-year group training and an evaluation of the group's process performance, perhaps using an outside facilitator. Although this may initially seem like an unwise use of time, research suggests that it actually saves hours because it improves the efficiency of the group and, as a result, pays off in quicker and better decisions in the long term.

You may also want to develop key crisis scenarios and get agreement on what the appropriate board response is to each – whether it's subpar performance, a takeover bid or an accident or health issue that disables the CEO or board chair. For example, who

is charged with calling and chairing a crisis meeting in case something disables the chairman?

**8**     ***Establish broad measures of corporate performance.***

A balanced scorecard approach is needed to measure all the relevant areas of corporate performance: how the company is dealing with its customers, employees, vendors and communities; how it is performing financially, with a focus on how assets are being employed; and how it is cutting cycle time, improving quality and developing new products and services. This means – without becoming too enmeshed in details of company management – the board should have access to employee and customer satisfaction data, supplier information – as well as accounting and analysts’ reports and economic analyses.

**9**     ***Provide boards with information about company performance from multiple sources.***

There are a number of sources for data about corporate performance; using only internal reports is potentially misleading. Boards need to combine their own observations of corporate performance with reports from corporate staff, outside consultants and analysts to get a comprehensive overview. It may also be appropriate for board members to visit company locations to observe first-hand how well the organization operates and to meet with major suppliers and customers.

**10**    ***Schedule periodic reviews of the development plans for the corporation’s top tier of executives.***

Staffing top senior management positions and identifying key executives are important parts of the board’s role. In order to do these well, directors need regular information about the succession plans in place and what progress has been made.

It is a good idea to have key executives make regular presentations to the board so that members can become acquainted with them. Also critical is a succession plan that is reviewed at least annually with the board – including who the backups are for key positions, plus the

planned development of the top dozen or so executives in the corporation.

**11. *Provide independent board members the opportunity to meet without company executives present.***

Frequently, it is only when outsiders meet in the absence of company executives that they can discuss sensitive issues such as executive succession and CEO performance. There are several ways to make this happen: having outside board members arrive early for formal board meetings so they can meet for several hours among themselves; having them get together after the board meeting to discuss their reactions and identify issues that they feel need to be addressed in the future; or organizing regularly scheduled virtual meetings by telephone or video conferencing. Another useful approach is to have every board committee have on its regular agenda a time when outside directors can talk among themselves with no inside members or staff present.

**12. *Create a process for outside directors to call special meetings of the board and to place issues on the board's regular agenda.***

It is critical for outside board members to have the ability to meet when they feel events call for it – on short notice, for example, in a crisis situation – and to have a way to place issues on the board's agenda. Our board study shows that 27 percent of companies have a lead director who works with the CEO to develop the board's agenda and who can call special meetings of the board.

**13. *Formally evaluate CEO performance each year.***

The results of this annual review should play an important role in determining the CEO's total compensation level, including tying stock and stock options to performance. The annual evaluation cycle begins with the compensation committee and CEO agreeing to measure performance targets for the year and ends with a formal evaluation of how well these goals have been accomplished.

**14. *Be sure that independent directors control both the compensation and the corporate governance committees (or whatever committee selects and evaluates directors).***

Much of the critical work of boards gets done in committees, so the membership on these committees is critical in determining the amount of influence independent directors have over the operation of the corporation. The compensation committee should be made up solely of outside directors – and the committee charged with selecting new directors should also be predominantly, if not exclusively, composed of outside directors. In addition, key committees should be chaired only by outside directors.

**15. *Tie the compensation of board members to changes in shareholder value.***

The best way to ensure that the interest of the shareholders and the thoughts and actions of board members are in alignment is to tie a significant part of their compensation to changes in the value that shareholders receive. Our board study shows that 92 percent of all respondents think that directors should be paid partially in stock, and 71 percent say there is a requirement at their companies for directors to own a minimum level stock.

**16. *Set board member compensation based on what directors of other comparable corporations receive.***

There is no right answer to how much someone should be paid for being on the board; probably the most effective approach is to gauge what represents a reasonable compensation level by looking at what the competitive marketplace pays for similar labor. (The Korn/Ferry study shows that the average annual retainer plus per-meeting fee is a little over \$33,000.) As a starting point, determine what directors for comparable corporations are paid. It may make sense for an organization to pay more if its corporate performance is above that of its competitors – and board compensation plans should build in this type of flexibility in case the corporation does outperform its peers.

Otherwise, it is hard to argue for board compensation that is above average, without very good reasons

**17** *Evaluate each board member's performance annually.*

Board members should be given feedback about their performance to help them develop their skills and to motivate them to be effective board members. All too often, members are informally evaluated in a "hit or miss" process that does not provide good feedback or valid data. Typically, the appropriate people to evaluate board members are the other members of the board. This suggests a peer process in which board members evaluate each other and provide feedback about performance, including development needs. These performance appraisals should be made available to whatever committee is charged with nominating individuals to the board, so that underperforming board members can be replaced. Criteria could include how well board members understand the company's strategy, whether they stay abreast of current trends and issues impacting the company, their meeting attendance record and their contribution to discussions.

**18** *Regularly review the performance of the board as a whole.*

Although individual evaluations are important, it is also important to evaluate how the board performs as a total entity. This requires a formal annual review of board performance. One element should be a self-review, in which board members are asked to look at how the board has performed during the last year. Major investors may also be asked to provide their input. The data should be fed back to the board so that it has several sources of evaluation to consider as it discusses performance.

**19** *Schedule enough board and committee meeting time to be sure that key issues can be discussed thoroughly.*

There is no magic number of board meetings – our survey shows that, on average, outside directors spend 163 hours annually on board matters, including preparation time, attendance and travel. In

addition, a number of committee meetings may need to be scheduled to complement full board meetings – according to our survey, committees meet on average between two and five times a year.

At least once every two years, consider scheduling an annual multiple-day board retreat to review key issues and the overall business strategy of the organization. Informal dialogue – with board members keeping in touch via phone between meetings – is also important.

**20 *Provide board members with critical information in advance of meetings so that board time can be used efficiently.***

Board meeting time should be reserved for discussing the specific information needed to reach decisions so board members should receive all relevant data before the meeting and come to the meeting prepared. If information is difficult to understand, phone calls before the regular board meeting may be appropriate – and be sure that all board members have background information at least one week before every board meeting. (A staff person who works with the board can help make this happen.) A contact within the corporation who can discuss and provide clarification of each area of information in the report is also valuable.

## **In Summary**

New structures and procedures – the “re-engineering” of the boardroom that we are starting to see take hold – create new challenges. The role of the independent director is becoming more complex and more time consuming each year, and directors with the experience and time are becoming harder to find. And the toughest challenge of all is to have the wisdom, courage and diplomacy to make the appropriate changes that meet the expectations of shareholders, employees and the financial community alike.

The first step is an open dialogue within the board on how to improve corporate governance and performance. The “best practices” listed here are intended to help stimulate this dialogue so that boardroom practices continue to evolve to meet the new demands on corporate governance.