Marketing Instincts

Hugh Latif & Associates www.hughlatif.com Winter Edition 2003

Straight talk about corporate governance…

(and good stewardship, if such a word still exists…)

Six years ago when I initiated my second career by founding my management consulting practice, I predicted that North America would experience a revolution in corporate governance. Looking at public corporations that were increasingly owned by large institutional investors, it made sense to me that these institutional investors would want to see good corporate governance practiced by the corporations in their portfolio of investments. I could see many signs that were not right. Red flags like excessive executive compensation, stock options that were out of control, large public corporations that were strategically in trouble while the board looked nice and comfy, etc. These signs indicated that something had to change.

But the years went by and no revolution came. Bits and pieces of changes occurred here and there with corporate governance, but these changes were tepid to say the least. Then, all of a sudden, 2002 came and so much happened all at once.

More has been written on corporate governance during the last six months alone than ever was during the past ten or twenty years. More importantly, more legislation was successfully introduced by US congress and signed by the US President recently. These can also be described as sweeping changes in corporate law, corporate governance and securities regulation. More than likely, Canada will follow suit shortly. While legislation is important and necessary, it is market forces that make real change happen.

I wish I had written about corporate governance and published this article back in 1996 rather than now. Unfortunately, I did not.

If you are a director, aspire to be one, or a President of a private company that is considering forming an advisory board or simply interested in corporate governance, this four-page article summarizes key elements of corporate governance. I sincerely hope you find this concise information helpful, practical and insightful. It is backed by reasonable research and hands-on experience from serving on private boards.

The role of the board

While “volumes” have been written on the subject, here are seven specific key functions of a board:

1. Review and approve the company (or organization) strategy
2. Monitor the company’s performance
3. Authorize compensation
4. Make sure the company complies with all laws and regulations, maintains high integrity of the financial numbers, adheres to ethical standards and insures that risks are properly evaluated
5. Provide advice and counsel to management
6. Makes appropriate recommendations to the shareholders.

7. Replaces the Chief Executive Officer when needed. (This is a bit of a sticky situation with advisory boards of private companies.)

Raison d'être and primary objective

In a nutshell, the board exists and works to insure that management is doing a good job. The prime objective of the board is to build, grow and sustain shareholders' value. It is important however, to underline that a board does not come up with a strategy but approves of management's strategy. The board does not execute the strategy but monitors its execution.

Simple do's and don'ts

Here are a handful of simple do's and don'ts that will apply to 90% of any board and to almost any situation. **Keep these 10 commandments and you will not be disappointed.**

Two heads are better than one:

Have a Chairperson and a President. Do not group all the power into one position. All too often, the CEO is the Chairman, President, CEO and COO all in one. This is a recipe for feeding inflated egos and for establishing Royalty, not running a business.

Manageable numbers:

Keep your board to a manageable number of directors. Seven is a good number. Nine is another good one. Boards with an excessive number of directors dilute the "flow" and the "punch" in favor of administration and routines. If you have a complex or extremely large business, you can always hire external expertise. These experts can render their opinion or research but need not be on the board.

Age consideration:

Have a good balance of ages among your directors. Age and wisdom go together, no doubt just as youth and muscle usually cohabit together. I am not suggesting that board members come roller-blading into the boardroom but equally important, they cannot come in with their "walkers" either. (No offense intended)

Independence:

This is an obvious point, yet so many large public companies would not pass the test of independence. Independence has been defined in strange ways lately. Here is what my Funk & Wagnall's dictionary says: (1) Not subject to the authority of another; autonomous. (2) Not dependent on or part of some larger group, system, etc. (3) Not influenced or guided by others. (4) Acting so as to manage one's own affairs; self-reliant etc… For a board to be productive, you must have independence. A board composed of insiders is not a board. It is a fraternity.

Attendance:

This seemingly evident point may not always be enforced. What is the use of having "Pavarotti" on the team if he does not show up for the concert?

Number of boards:

To do a good job a director must attend 90% of all board meetings and committee meetings. He/she should also dedicate other days to reviewing documentation, research, reports, etc. How can one do this for many companies while simultaneously keeping a full time job? This is mission impossible for normal human beings. Four boards would normally be close to the maximum.

Conflict of interest:

To render independent opinion and maintain impartiality, directors should not have dual roles such as director and consultant…just director. You are either a director or a consultant. You are either the auditor or the consultant, but not both at the same time! Keep it simple.

Evaluation of the CEO and the board:

Although this is indeed a prime role of the board, recent research indicates that a large number of boards of public corporations do not conduct a CEO evaluation. An even larger proportion of boards do not evaluate the board's performance. Yearly evaluations are healthy. They foster open and improved communication and reinforce the accountability factor. Evaluations need not be elaborate and administratively heavy. They are good tools to track results rather than activities.

Strategic plans and succession plans:

While most corporations have annual budgets, business plans and objectives, many do not have a strategic plan or if they have one, they fail to keep it updated. The vast majority of companies do not prepare formal succession plans. These are two important tools for the board to appraise management performance.

Meetings with and without certain people:

Opinions will vary on this one, but I always recommend that at least one or two meetings a year be conducted without the attendance of the CEO. This is not to encourage "gossip" but on the contrary to avoid it by giving directors the opportunity at least once or twice a year to speak their minds openly. In addition, I also encourage that the board meets without management with the auditors. These are healthy habits.

Most common skills of directors

Directors should be recruited for their skills, experience and talents and not for their friendship. A strong board can be a tremendous competitive edge for the management team and for the shareholders. A strong and well-balanced board will attract a strong management team. A strong management team will produce positive performance. Here are the most common skill mixes:

- Financial experience and knowledge
- Strategic skills
- Sales and marketing experience and know-how
- Human resources expertise
- Technical and production proficiencies
- Information technology skills and capabilities
- Legal expertise

The above skills are the core and fundamental skills that are needed in any board. By contrast, the following skills are more specialized and may not apply to all organizations: Lobbyist talents, academic prowess, door opener (contacts), international experience, research & development expertise, specialized legal know-how, expertise in special categories such as the environment, etc.

Selecting directors and the board's "chemistry"

Selecting directors is a key factor in the success of the board. Not only must the "talent bank" be rich but also the chemistry between board members themselves and then between them and the CEO and the Chairperson must be OK. This is easier said than done of course, but unless the team is flowing together, performance will suffer. What sets a good orchestra apart from the rest? It is not only the individual dexterity of each player but also the ability of the players to perform as a team under strong and experienced leadership. Many boards staffed with qualified directors fail to deliver simply because the chemistry is not right.

In private companies, and to a large extent, public corporations as well, CEO's prefer to select directors they can trust. If they happen to be close friends, that is better. If in addition, they are also qualified or look qualified on paper then, this is great! This is motivated by the CEO's desire to have an "easy" board and to avoid potential criticism and possible "conflicts". This, however, is a recipe for failure, as a weak board with a "rubber stamp" style will eventually be disastrous to the corporation and ultimately puts the shareholders value at risk. In the past year, many public companies were devastated by incompetent management strategies. Indirectly, sleeping board members were at the root of this incompetence.

As I counsel CEO's of privately held companies to build advisory boards, I encounter hesitance to appoint independent directors. This is because CEO's would instinctively like to select people they can trust as directors. Trust is key but what is trust? Isn't trust built on high integrity, strong ethics and adherence to high professional standards? Then if we make sure that these criteria are present, trust will be built as we work together. If a director has all the qualifications in the world but lacks integrity, he/she does not qualify in my opinion at all. Integrity, ethics and professional conduct are not optional. These are pre-requisites. Having said that, you just cannot go and hire all your friends; Yes they may be trustworthy and great to go fishing with, but we are not going fishing. You also cannot just recruit all family members, even though they may be co-owners. At some point in time, companies grow to a size where a separation between ownership, management and directors is needed. You do not control by personally being on the board. You control more effectively by insuring that you have a strong and well-qualified board.

Four steps

First you appraise what your needs are. **Second**, you specify the skills, talents and experience you require. **Third**, you go find them. **Fourth,** you also check for the chemistry. When you have completed all four steps, you begin! Once the board is formed, you then must adjust, correct, add, replace, recalibrate, fine-tune, etc. as you go.

Good stewardship

Good corporate governance is about good stewardship. People entrusted with the affairs of the corporation. People assigned to oversee the affairs of the corporation. Custodians are given the responsibility of preserving and growing shareholders value and not about getting rich fast. If these descriptions need explanation, then I have missed the point of good governance! I hope and trust you have found the many points and tips contained in this issue of Marketing Instincts practical, insightful and helpful. If you have, I hope you will put them into practice.