Expert View

How To Fix Corporate Boards

Janice Reals Ellig, 06.29.10, 7:25 PM ET

Better boards are the key to avoiding mistakes of the past.

How quickly we forget. Less than two years ago news headlines screamed "Where was the Lehman board?" Pundits pontificated about drastic changes in store for corporate boardrooms across the country in the wake of big bank and insurance company failures and the near collapse of the U.S. markets.

With so much at stake what has changed? Not much. Why should it? After all, our economic indicators are tentatively heading in the right direction, and unemployment, though still hovering around 10%, has stopped climbing. The recent stock market rout has rattled investors, but many still don't connect the market's performance with the boardroom.

That's unfortunate because when left to its own devices history has a way of repeating itself, and the best way to make fundamental change in corporate America is to change boards. That means making sure directors are well-informed, savvy, asking the right questions and willing to hold senior management accountable.

U.S. Bancorp, the fifth largest U.S. bank, has repeatedly been touted for having weathered the financial storm better than most other institutions. Its U.S. Bank unit surpassed industry averages in client satisfaction and topped the four other largest banks in the fourth quarter of 2009, according to the American Customer Satisfaction Index (ACSI).

In assessing a board, the following four questions can be a guide to raising the level of board competency and bringing good corporate governance back to the decision-making process.

What experience do individual board members provide? The whole board should be greater than the sum of its parts. As Rick Goings, chairman and CEO of Tupperware, told *Directors & Boards*: "We've got an incredible board. Everybody brings something to the party." The company reorganized itself when it was spun off from Premark in 1996, bringing in directors with needed expertise. Tupperware's directors have experience in emerging markets, women's buying habits, auditing, managing local businesses, branding and marketing, start-ups, finance, investments, human resources and pay plans.

When recruiting new board members, the nominating committee needs to ask: What is the strategic business direction of the company and do the individuals at the table measure up to the specific needs? What are the gaps in the board's experience relative to risk, international operations, marketing, finance, legal or strategy expertise?

Does the board think diversely? People from different walks of life, cultures, educational backgrounds, ages and genders bring different perspectives to a discussion. People now age 45 grew up in a world different from those age 65. Women and men approach situations differently. Those from different places have different perspectives of the world.

Boards need to make sure that in today's rapidly changing marketplace all perspectives are represented. Increase the number of women in the boardroom and on the executive floor and a company is likely to significantly improve its returns, studies by McKinsey & Co. and Catalyst indicate. Among S&P 500 companies, the stocks of the 15 led by women gained 46%, vs. 25% for the universe as a whole.

Norway has required that women comprise 40% of every public company board since 2008. France and Spain are moving in a similar direction. If U.S. boards fail to increase the number of women directors, they too could someday face a government mandate to do so.

Is the board committed to making changes when necessary? Evaluating the board is a mandate of every nominating committee. A director's term should not be renewed if he or she does not have the type of expertise the company needs, an open mind and a serious commitment to the board's work. CA (formerly Computer Associates) was grappling with senior management scandals in the 1990s and at the same time it was reconstituting its board. Directors knew they needed a strong board to redirect and re-brand CA.

When engaging search firms, boards must demand that the slate of "viable" candidates be diverse as well as experienced, committed and of high integrity. Search firms should also look beyond trophy names.

What is the tone at the top? Even when things are going well, directors should be vigilant with the chairman and chief executive. They should constantly ask: What scenarios are we *not* considering? What might a perfect storm look like? Beyond the numbers, a board should vet strategy, discuss risk and evaluate the performance of the CEO and his or her team.

A growing view is that the roles of chairman and CEO should be split. Currently 37% of S&P 500 companies separate the roles, compared with 20% a decade ago. How can one individual run the company and the board without conflicts of interest, like approving one's own compensation? At Merrill Lynch, the board signed off on a pay plan which significantly benefited senior management, including the chairman and CEO, E. Stanley O'Neal, as the company tottered toward disaster and a rescue by Bank of America.

To truly fulfill their mandates, boards must protect the interests of shareholders, employees and the communities in which they operate. A strong, committed board is all that's required to keep chief executives on track and make sure companies are led responsibly and with integrity.

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