

Signs Of The Underperforming Board

by Lana J. Furr and Richard M. Furr, Ph.D.

Too many boards fail to perform up to their potential—but why? What are the most common causes of board oversight failure? How does your board diagnose the weaknesses that hold it back? Finally, does your board have the collective will to confront and correct these problems?

The company was under heavy fire from the regulators. A consultant, brought in from the outside to right the ship, evaluated the management staff and the board. After crafting a new strategic vision, he recommended hiring a new CEO from the outside, two additional C-level officers, and board evaluation and development by outside professionals.

The board, which was composed of the same directors who were governing during the missteps that brought in the regulators, declined each suggestion. They promoted a CEO and two officers from within and decided they did not need outside professionals to assist the board. The consultant departed, and they have satisfied the regulators. While things are back to “normal,” performance has continued to decline and results are mediocre at best compared to the industry.

The corporation described above is back in compliance, but is the board performing well? Are directors fulfilling the role of the board that governs not only the organization but itself as well? There were other signs of underperformance, but shareholders would not have seen them. The shareholders simply ask, “Where was the board when all this was going on?” and “are the problems really fixed?”

Sarbanes-Oxley legislation, heightened governance and independence requirements, and redoubled scrutiny of institutional investors were supposed to assure investors that there will be no more malfeasance or

inattention from boardrooms. That is a good first step, but is it good enough when stakeholders expect performance, not just compliance?

The best indicators of a board’s performance are to observe what directors pay attention to, how they do their work, and how the board prepares itself to meet future demands.

Effective boards are not created based on legislation, structure, reporting requirements and independence tests alone. Boards are more savvy in dealing with compliance issues since 2002, and their corporate attorneys and external auditors have assured that they can meet and pass the regulatory tests.

It is more indicative of a board’s performance to observe what directors pay attention to, how they do their work, and how the board prepares itself to meet future demands. The signs and symptoms of a troubled board are usually hidden behind the boardroom doors, but they are easy to detect.

Good directors see these signs and are concerned while others do not see the dysfunctionality, do not want to disturb the status quo, or disrupt the camaraderie that has developed among directors. Directors reveal the following symptoms that indicate the board is potentially underperforming in its role.

Too little time to do the work.

Many boards are in danger of glossing over very important matters that need their attention. The workload of boards has increased significantly since the advent of Sarbanes-Oxley. Regulators continue to put more oversight onto the plate of directors—time taken from assuring corporate performance.

A 2007 corporate board effectiveness study by

Lana J. Furr and Richard M. Furr, Ph.D. are partners in Furr Resources consulting, Greensboro, North Carolina. [www.furrresources.com]

Heidrick & Struggles and the USC Marshall School of Business reports that directors spend an average of 16.8 hours per month on board work, an increase of over 29 percent in five years. Since many directors of the large caps serve on average from two to three public boards, they are unable, or unwilling, to devote more time to board service. Directors still active in their own career pursuits may not be able to commit more than two days per month to another company, and yet most boards prefer to have a majority of members who are still actively engaged in business. This symptom shows up anecdotally when board leaders discuss the need for retreats to conduct strategic planning, board development and education.

We interviewed the CEO of a company who was the fourth CEO hired within two years. The organization struggled through the travesty of poor hiring decisions and lack of capable oversight. A new chair with business acumen has now joined the board. He and the CEO decided that a board development and strategic planning retreat was needed, since most directors were the same as those who presided over the fiasco of the past two years.

They received replies from directors that they were not interested because it would take too much time. Directors said, “Keep it short,” believing they should be able to accomplish a board development retreat and strategic planning in one day.

Consequently, the development and planning work is simply not done. Management is left to do the thinking, and the board does not really understand, or become committed to, the strategy. Further, the board does not take the time to learn more about what is needed to perform well in a contemporary governance role.

□ *The board’s role is too narrowly defined.*

When most of a board’s time is focused on compliance and meeting regulatory requirements, the board becomes myopic. It becomes consumed with monitoring tactical aspects of performance, looking in the rear view mirror, while the future of the company is ignored.

It is helpful for boards to think of their leadership role as having four dimensions. The most important

dimension is *directional leadership*. Directional leadership is the key component of the board’s and executives’ roles. It includes:

- Planning, envisioning and conceptualizing the future.
- Strategic thinking.
- Creative thinking.
- Ensuring that the company’s core ideology will successfully support the strategy.
- Maintaining perspective from the “30,000 foot level.”

When boards become mired in compliance issues and monitoring tactical performance, they are seduced into *implementational leadership*. This is the concrete, number-crunching work that belongs mostly in the domain of middle managers.

An example of this was the board of a publicly owned bank. Directors were getting the reports of insufficient funds checks. They were convinced that it was their fiduciary responsibility to monitor at this level. This same board had little time to discuss the future of the bank. It was no surprise to us that they were acquired soon after we talked with them.

When the board is mired in details, it cannot be “on the hillside” helping management. Shareholders expect the board to be preparing for and helping shape the future.

A Heidrick & Struggles survey indicates that while 95 percent of directors are pleased with their fiduciary oversight, only 59 percent favorably rate their boards’ role in shaping long-term strategy. Only 12 percent of directors believe they are “very effective” in this arena.

When the board is mired in details, it cannot be “on the hillside” helping management keep an eye toward threats and opportunities affecting the industry. Any board that inadequately attends to the future of the company is underperforming. Shareholders expect the board to be preparing for and helping shape the future of the company.

A second area that is frequently shortchanged due to overindulgence in compliance is adequate

Four Dimensional Leadership Where Does Your Board Fit In?

	Implementational Leadership	Personal Leadership	Interpersonal Leadership	Directional Leadership
Board of Directors	Integrity	Trustworthiness	Empathy	Plan Vision
Senior Management	Tangible	Projects	Team player/member	Innovative
Middle Management	Concrete	“Doing”	Influence	Core ideology-values/purpose
Front Line Management	Tasks	Numbers	Egoless	Passion
	Production	Machines	Pragmatic	Ideas
	Quantitative	Follow through	Realistic	Facilitate
		Execution	Confident	Competent
			Open	Facilitate
			Self-mastery	Mentor
			Manage relationships	Encourage others
			Sustain Performance	Encourage others
			Collaborate	Encourage others
			Champion change/organizational learning	Encourage others
			Think strategically	Encourage others
			Develop teams	Encourage others
			Concepts	Encourage others
			Culture	Encourage others
			Abstract	Encourage others
			Intangible	Encourage others

Source: Furr Resources, Inc., Greensboro, NC

attention to succession and the depth of talent on the bench for the future. A few years ago, one of the major executive recruiting firms stated that 40 percent of key managers brought in from the outside fail within 18 months—typically at a cost of 150 percent of salary. Additionally, authors Jim Collins and Jerry Porras found that the companies that have proven “Built to Last,” such as Procter & Gamble and General Electric, have long tended to groom successors from within.

However, too few boards pay much attention to developing “home-grown talent” and succession. A

PricewaterhouseCoopers survey from 2005 reported that nearly half (47 percent) of survey respondents were unsatisfied with their company’s succession planning efforts. Who on their boards is calling attention to that deficiency? Who is leading the effort to see that the planning process is improved and getting the results it will need to assure capable talent will exist to address future challenges?

Boards also often neglect attending to their own need for crisis management planning. This is planning the board cannot delegate. It is the board’s plan for handling an emergency only the board can handle,

for example, when the CEO is at the center of the problem (perhaps engaged in something illegal or becomes gravely ill).

When we point out the need for contingency thinking to boards, they often shrug it off and say they have too many urgent things on their plates to tackle crisis planning. How can a board claim that it fulfills its fiduciary responsibility when it does not plan for crises that can wreck the company's value?

Boards are also routinely neglecting their own development and education. In light of the amount of change in governance during this decade, you would think that directors would have no problem seeing the need for ongoing education and establishing a requirement for it. Yet many directors resist attending even one training per year. While 74 percent of directors believe that their full board evaluation process is effective, only 41 percent believe they do a good job evaluating individual director performance.

Our own experience is that while directors think they do a good job on these areas, their work is often cursory and not resulting in actions that are implemented. Less than two-thirds of boards provide regular training for directors. How does the board improve performance when it does not stay up-to-date on what is required for effectiveness?

□ *Shareholder unrest.*

Not all shareholder demands suggest an underperforming board. There are numerous examples of noisy shareholders taking boards to task to further their own personal agendas, which do not necessarily reflect the best interests of all shareholders. On the other hand, when shareholders rattle their sabers, it must be investigated.

When major investors have concerns about board decisions, they cannot always be dismissed as rogues. After the lessons of Enron and others, shareholders (individual and institutional) are not reluctant to step up and question, especially if it looks like the board is ignoring a growing problem.

In one example, a key shareholder watched as problems mounted and the board took a "wait and see" attitude. He firmly believed that there was a problem with leadership. He repeatedly called the chair and requested meetings to press for action.

Eventually, troubling problems emerged and the CEO was replaced.

After the new CEO came on board, the extent of the problems was revealed, but it was too late to fix them. The board had to sell with conditions that pleased no one but the buyer. The board was too trusting of prior management, it was too cautious in making changes, and did not ask enough questions soon enough.

Beyond managing the workload, it is critical that directors have the competencies needed to make a strategic contribution and exercise their responsibilities.

□ *Wrong talent on the board.*

The average board in corporate America has 10 or 11 directors, roughly the same size they have been for the past decade. Yet, the workload has increased to the extent that each director must be highly engaged and making a difference at all times. He or she must make a valuable contribution to at least two or three committees. There is no place for slackers.

Beyond just managing the workload, it is critical that directors have the competencies needed to make a strategic contribution and to exercise their fiduciary responsibilities. Unfortunately, that is not as often the case as it should be for optimal performance. In a McKinsey director survey conducted in 2002, 44 percent of directors were judged by their peers as not understanding the key performance indicators of the business. Ironically, in our own practice, we find 95 percent of directors think they outperform their peers in most areas of board work.

How can directors who do not understand the balance sheets and key performance indicators help make strategic decisions? How do you develop a high performing board when about a third of directors are capable, some do no harm but do not make a positive difference and 44 percent could be called questionable?

Beyond lacking competencies, directors sometimes commit the worst offense of all, which is apathy. These are directors who are able but *unwilling* to:

- Engage meaningfully in board deliberations.
- Challenge when they have a serious concern.
- Participate in strategy retreats or board development work.
- Leave the beach to travel to board meetings so they participate by conference call repeatedly.
- Make a difference in committee work.
- Resign not recognizing that shareholders are short-changed by their apathy.

When a director runs amok without board leadership addressing the problem, boards become distracted from the business of governing.

□ *Misguided directors.*

Another sign that a board is probably underperforming is when members report a “rogue director” in the ranks.

One director, a CPA, believes he is within bounds to circumvent the CEO and tell managers what to do. He brought a new client to the business and insisted that he should be able to control how the deal was structured. Much time is wasted by board leadership and management trying to do damage control because of his effects.

In another case, a director uses board meetings as a bully platform to humiliate and alienate management, playing “one-up” games instead of collaborating. Some of the directors support him, others see how he creates divisiveness, and others feel intimidated by him. No one wants to deal with him. The chair has held several meetings with him, but so far, there has been no lasting change.

When such directors are allowed to run amok without board leadership addressing the problem, directors become distracted from the business of governing. We have seen numerous instances where directors privately discuss the problem with each other outside the boardroom, but it is allowed to continue without leadership intervention. That is a symptom that the board is dysfunctional in fulfilling its role. Eventually, most of these boards underperform because of the distraction.

If a board delays replacing a CEO due to risk aversion and not wanting to “make waves,” there is clear underperformance of duty.

□ *Lingering questions about CEO/organizational performance.*

One of the key contributions of the board is to make sure they “get it right” when they choose the CEO. Because it is disruptive to change CEOs and deal with the disequilibrium created in the marketplace and shareholder disquiet, many boards overlook problems in CEO performance.

For example, the CEO has allies on the board who believe that he is on the right track strategically and simply needs more time to make the strategy pay off. Some on the board are skeptical, and others believe it is time to make a change. Directors respect each other, like each other and do not want to create disruption, so they delay an intensive conversation because they do not know how to have it. They hate to “call the question” on each other’s judgment. In the meantime, company performance continues to plummet.

Another CEO has not done a thorough job of keeping the board informed. Board members are surprised by strategic actions that catch them off guard. They request more information, sooner, and the CEO promises to deliver. However, the CEO continues to act unilaterally. Instead of defining clear expectations between the board and CEO about decisions that must involve the board, the board continues to react to the last decision. Performance and trust continue to suffer. The board is averse to taking the risk of changing the CEO.

In yet another example, a CEO’s personal behavior (alcohol, drugs, extramarital affairs, etc.) jeopardizes the company’s reputation. Directors closest to the CEO discuss the situation and receive assurances that everything is under control and under wraps. They want to believe the assurances. Then, the news breaks on the front page of a newspaper. The board has no crisis plan, and there may or may not be an appropriate successor in the wings. There also may or may not be a communication plan for doing damage control with the press and the street. The board

has underestimated the problem early on and has underperformed for shareholders.

There is no “absolute right time” to replace the CEO. However, when boards delay due to their own risk aversion, not wanting to “make waves” with other directors or because they are friends of the CEO, there is a clear case of underperformance of duty.

“The longer the wrong person serves as chairman, the weaker the board grows.”

□ *Board leadership lacking.*

The last symptom of an underperforming board is a clear lack of board leadership. This should not be an issue in companies traded on the major exchanges, but it is. Douglas Austin, chairman and CEO of Austin Financial Services made a simple but profound statement in the *ABA Banking Journal*: “The longer the wrong person serves as chairman, the weaker the board grows.”

It is said that the chair of the board is first among equals, but that is not the case. Not all directors have leadership capability and so not all directors are equal candidates to serve as chair. Too many board chairs are chosen without considering competencies. Instead, they are chosen due to seniority, it is their “turn,” as a political payback, the amount of shares they own, or other inappropriate reason.

The result may be a leader who is seeking popularity, who delivers favors and is looking to have them reciprocated, who enjoys the power trip but does not do the right thing for the company. This is a person who may well have the insight, intellect and ability to persuade, could make a strong contribution, but does not.

For example, one chairman was consumed with the importance of being an independent board chair, especially since his father was also a past chairman of the company. He was an attorney, and wore the cloak of the position’s weightiness by pondering over details, and staying in the weeds of tactical decisions. He smothered the input of other directors and burdened the management team with continuous requests for more and more information, when they

needed speed to respond to a highly competitive marketplace. He was highly risk averse, and felt the need to make decisions without much board input. Eventually, the organization lost a very capable CEO who could no longer abide the situation.

Another chairman, of a publicly traded company, is a steamroller—he sucks the air out of the room when he enters. He refers to the firm as “my company.” He has his own vision for its future. The CEO, the rest of the board and management share an aggressive strategic intent to grow through acquisitions. However, the last target they approached said they were unwilling to enter discussions as long as this chairman was still on the board.

Finally, the founding partner of a fast-growth company was named chairman of the board. As time passed, he discussed with his board that he did not want to be chair and that someone else would be better suited to the role. His greatest contributions would be in other capacities.

The board ignored his requests to name someone else chair until we intervened and suggested that his request deserved attention. The other board members simply did not want the responsibility or did not have time to fill the role. They had not thought about chairman succession, or prepared their board with candidates who were suitable for such a leadership role.

When you see a board that fails to fulfill its responsibility, that shortcoming falls squarely on the shoulders of the chair. It is not enough that the chair is likeable. He or she must know the organization and something about the industry. Chairs must be persuasive, able to work well with many types of people, handle difficult situations that arise among board members, think strategically, facilitate sometimes contentious discussions, etc. Finally, it is critically important for a chair to recognize when it is time to step down from the role. A weak chair leads to a weak board.

When the board is underperforming, the best directors can define the board’s strengths and weaknesses precisely.

When the board is underperforming, we see and hear many different reactions. It is like the story of the blind man describing an elephant. If he has touched the trunk, he may describe the elephant as a long and cylindrical animal. Another blind man may describe the elephant as thin, flat and fan-shaped if he has felt the ear, and so on. Each perception is true—but leaves out other vital information.

Like the blind men, directors' experience of their boards depends on their insight and perception, on how they see the board from their experience. When the board is underperforming, the weak directors do not see the signs. They enjoy the perks of board membership. They will usually report that they have a "good board" and will talk about the diverse backgrounds and camaraderie of the members. When pressed to name an improvement area, many cannot.

The best directors can define the board's strengths and weaknesses precisely. They are especially troubled by the signs mentioned above. They will discuss actions they have already undertaken to try to influence the board to act. They are effective to the extent that other informal and formal leaders

also see the need to improve.

A third group within the board sits on the fence. They can often be influenced by the informal leaders, with some effort, to "go along with" taking action. It depends upon the persuasiveness of the directors that see the need. Other times, they are persuaded to do nothing.

With insight into the problems, the support of informal leaders and assistance from an outside professional, an astute chair can lead the board back to performance. If the chair is part of the problem, the informal leadership has a more difficult role to play.

When the board is underperforming, unfortunately it is usually the CEO who takes initiative to create movement. He or she has the most at stake if the board is an impediment. We have seen highly effective CEOs take the lead repeatedly and with positive outcomes. Those who act know too well that they cannot allow the board to languish if they want the company to thrive. The board has to work through the issues and move beyond compliance to *performance* in order to be a strategic asset. ■