Building the Power Partnership:
Some Rules of the Game for CEOs and Their Boards

Robert K. Mueller

One of history's most remarkable organizational achievements is the large public enterprise governed by an independent board of directors. It has served society well for most of this century as an unrivaled creator of wealth, employment, social services, and benefits.

However, the rules of the game that govern corporate governance are shifting. Unless actions are taken to improve the conduct of all publicly held corporations, this organizational form may become an endangered species. Strong measures are needed to preserve it, both in the for-profit domain and in the nonprofit domain of public undertakings.

Increased activism of boards is evident in most developed regions of the world. The media coverage of the replacement of CEOs by the boards of General Motors, IBM, American Express, the United Way, and Empire Blue Cross/Blue Shield reflects a new breed of directors. Example: The United Shareholders' Association, a group of small shareholders, contacted Sears Roebuck's 1,000 largest shareholders, who have 70 percent of the votes, to require separation of the job of chief executive from that of the chairman as a measure to improve the effectiveness of the board and the management of Sears. This controversial action is just one of many taken to improve boardroom effectiveness.

Ticking timebombs were placed under the tables of corporate boardrooms across Britain in December 1992, when the committee of enquiry chaired by Sir Adrian Cadbury issued its recommendations on corporate governance. There were two key sets of recommendations. First, that there should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the CEO, it is essential that there should be a strong and independent element on the board, with a recognized senior member. Second, that the board should include nonexecutive directors of sufficient caliber and number for their views to carry significant weight in the board's decisions. These recommendations have focused attention in the U.K. on the role of nonexecutive directors to provide independent judgment on issues of strategy, performance, resources, key appointments, and standards of conduct in corporate governance.

Over the past year, the actions of institutional investors confronting boards of directors of enterprises in which they have significant shareholdings have galvanized passive boards to take action to correct company performance. Calpers (California Public Employees Retirement Fund), the big California-based pension fund, has been a leader in this assault, not only in the United States but overseas. For example, in an unprecedented critique of a leading German company, a Calpers representative appeared at the annual meeting of RWE, Germany's eighth-biggest industrial conglomerate, and denounced the voting restrictions in place at dozens of leading German companies.

The public and shareholder concern over corporate performance is worldwide, with the focus of activism varying by region. Japan's *Keiretsu* system of cross-ownership of corporations presents a different legal, cultural, and political framework from the business environment in Latin America or Southeast Asia, where ownership patterns, government regulations, statutes, and historic business practices dictate the relationships between the chief executive and the board. Nevertheless, there is a renaissance underway and the rules of the business game are changing as investors and corporations globalize their activities.

The ferment over governance of corporations is relatively unrestrained by geographical and political barriers. It is useful to tackle the generic problem of building a power partnership between the CEO and the board by taking a close look at the basic issues in a region where the „rules of the game" are well known. The discussion that follows is set primarily in the North American scene, but the issues it addresses will have relevance worldwide.

The Power Partnership Revisited

The CEO who does not use the board as his or her biggest asset, greatest strength, and conscience is an executive who does not understand the potential power in the partnership between management and its board. When the latent power of the board – not always in evidence, but very real – reinforces the CEO's kinetic, demonstrative power, they create a stronger corporate whole.

But to build and maintain that power partnership, the astute CEO and the board must understand the rules of the game, from selecting board members and fostering their participation in the company's affairs to recognizing the signs of danger and weeding out ineffective members.

Picking Your Parents

The people who sit on the board become the CEO's bosses – in effect, his or her parents. It is a strangely

balanced relationship, with one collective party holding the authority to fire the other. What the CEO should look for is a group of people who will provide the kind of support, counsel, and oversight the corporation and the CEO need. Ideally, board members are heroic: they bring courage, bold enterprise, intellectual power, and nobility of purpose to their work. They are leaders who raise ambitions, expect a higher standard of performance on almost any task, and whose very presence makes everyone work harder and smarter.

„Be careful, though," warns David L. Coffin, chairman of Dexter Corporation, the oldest firm on the New York Stock Exchange. „They're easier to get than to unget." The trick is finding the right balance of people – individuals who can diversify the board with their talent, whether it is in technology, education, management, or marketing. Outside board members, says Coffin, should be „people you cannot afford to hire, because if you could, you would," and they should be „more than just one-day-a-quarter people."

To encourage change and anticipate market problems, the sage CEO looks for differences in background, value systems, and attitudes among his board members. He seeks out directors who have the depth to be on the lookout for „what-if" situations. Edgar Monsanto Queeny, in charge of the company his father founded in 1904, looked outside comfortable industry choices when he added Charles S. Cheston, an investment banker at Smith, Barney & Co., to Monsanto's board. While Queeny knew Monsanto's business, Cheston knew international finance.

In 1945, as vice president and general manager of Monsanto's plastic division, I petitioned the board for a half-million dollars to build a new polymerization plant with potential return on investment well beyond the company norm. My division had prepared carefully for our board presentation, with surveys of the product's potential market acceptance, a review of the proprietary technology involved, production-cost estimates, and more. We were ready for all questions – or so we thought.

I made the presentation and asked the board for its approval. Silence reigned, and then Cheston leaned over and whispered something in Queeny's ear. „We like the idea," Queeny said, and then – without skipping a beat – added, „When would we be able to go beyond your proposal and build plants in Mexico, Argentina, and Britain?" I was stunned – and stumped. Cheston had had the vision to comprehend the full potential of the project, and Queeny had had the intelligence to capitalize on his colleague's knowledge.

In the not-so-distant past, directors came out of the „old-boy" system. They were people the chairman or CEO had known for years and had often done business with. But today the rules have changed. The government, realizing that having people who are paid to serve the company also perform as board members poses a potential conflict of interest, has laid down strict regulations. Most companies try to avoid the perception of conflict of interest by keeping such outside contractors away from the formal decision-making and fiduciary roles of the board. But while pressure from major investors and the SEC has encouraged the use of nominating committees dominated by independent directors, the fundamental principles for selecting the right kinds of board members still apply:

• Seek intelligence.

• Look for wisdom that complements your own.

• Be prepared to manage contentiousness, but be wary of complacency.

• Look for people who are willing not just to lead, but to inspire.

• As your company's needs evolve, don't hesitate to reconstruct your board to better meet changing business patterns.

The CEO's Role in Building the Partnership

The ideal relationship between the CEO and the board calls for the CEO to provide leadership while the directors tend to the governance of the company without getting overly involved in its day-to-day operations. The wise CEO studies the strengths, weaknesses, and interests of each director to ascertain who adds value and who doesn't. Once he has completed this process, he gets on with the task of building the partnership.

The styles of director participation on a board generally fall into three categories:

Nose In, Fingers Out. NIFO directors work well in most corporate environments and are the kind of director most CEOs prefer. These independent, outside directors concentrate on overseeing and monitoring management's performance and then get out of the way, remaining readily available as a resource when the CEO needs help.

Nose In, Fingers In. NIFI directors care too much about the company's financial performance, get too involved, and are too nosy, but their strengths should be recognized: they can ground discussions in pragmatic reality, defining what's possible and what's not. They also bring an insider's perspective, and can help educate outside directors. As long as NIFO directors outweigh the NIFI exceptions, the CEO can maintain the equilibrium he needs to sustain the partnership of power.

Nose Out, Fingers Out. NOFOs are often some of your oldest associates – people who have been with your board so long that you might not notice their disinterest. They cause two kinds of indirect harm: they fill a seat that could be taken by someone who would contribute to the company's well-being, and their disinterest can give peers the idea that a directorship on your board is a passive honorary position. The wise CEO confronts NOFOs head-on, recognizing that the power partnership between the CEO and the board works best when the independence is equal, the dependence mutual, and the obligations reciprocal. Arm's-length directors have no place in it.

Tom Tyler, president of Shuttleworth, Inc., a family-owned company in Indiana, inherited two NIFI directors when he came to the company in 1980 and set about assembling a new board that could help the company grow beyond its entrepreneurial roots. The NIFI directors were minority shareholders excessively concerned about the company's financial performance and the return on their investment, but Tyler sensed that they had been around long enough to know the company's long-term strengths and weaknesses – knowledge and experience that Tyler wanted on his board. To eliminate any conflict of interest, the company bought out their interest and then paid them a fee to continue as board members. „They felt that they were being properly rewarded for their skills," Tyler says, „and they loved the company." They became NIFO directors.

Part of the formula for turning a NIFI board of meddlers or a NOFO board of nodding heads into a NIFO board of directors is communication. The CEO, says Tyler, has a clear mandate to build „a sense of trust and belief in each other, so you can say anything you wish. Seventy percent of our time with the directors is spent on education. Thirty percent is invested in asking them for input on the information we've passed on to them. I've been on the board of directors for more that 10 years and there has never been a major decision that wasn't unanimous."

The balance of power – and ultimately, the long-term success of a company – depends largely on a board independent enough to counsel, a chairman smart enough to listen, and a CEO or president strong enough to act. All of them – the CEO, the chairman, and the board – must have a clear understanding of their roles and their respective powers at different stages of the company's development.

The Care and Feeding of Directors

There are few written rules of conduct for galvanizing the latent power of the board and the kinetic power of management into a noncompetitive alliance. In the „care and feeding" of independent directors, each board poses a new set of problems and demands a new set of solutions. Some guidelines do exist, however, for pointing an intelligent executive in the right direction.

Get to know your board. An important part of building a CEO/board relationship is the effort the CEO makes to get to know his or her directors – their expectations, value systems, ideology, codes of behavior, and personal agendas. It's a special challenge for the CEO, given the directors' role in appointing, supporting, or replacing the CEO. The style, process, and nature of such exchanges can be much more emotional or distant than the relationship the CEO has with subordinates. One-on-one sessions to discuss individual interests and expectations on the issues before the board are very effective, perhaps even critical, because failure to keep in personal touch with independent outside directors may cause them to lose confidence in the CEO. One executive, the chairman of an insurance company in the Midwest, goes around to each board member during executive sessions asking, „What's happening in your business that might be helpful to us? What do you see that would be helpful to the other board members?"

Make your directors welcome and informed.

In 1977,1 became chairman of Arthur D. Little's board. To take advantage of the breadth of the directors' intellectual backgrounds, international business acumen, and professional experience, I set to work with John F. Magee, our CEO, to more directly involve them in our company's affairs. We dedicated a third of every board meeting to staff presentations on client projects. We assembled a directors' handbook that detailed the company's compensation plans, code of conduct, bylaws, and history, and included current biographies of the directors themselves – all the information they needed in one neat package. We also made sure that the directors and their spouses became familiar with products and innovations that were the work of our company or our clients, and we gave them tours of our facilities. A formal annual dinner for directors and their spouses rounded out our agenda.

What is enough information? Concludes one CEO, „Give them more than they want and more than you would ordinarily think a director should have. You never want them to be at a point where they have to seek you out because they don't know enough." While the effort to inform and welcome may seem a large investment in time and energy, it can stand you in very good stead during times of crisis, such as mergers, divestitures, acquisitions, and takeovers.

Avoid overfeeding. The CEO of a midsize Midwestern manufacturing company canceled a board meeting that would have included a trip to the company's Irish plant when he realized, „it wouldn't have been conducive to the goodwill of our people, who had missed their profit sharing that year, to realize we were waltzing the directors around overseas." Another retired chief executive remembers when his company invited the board to a conference center in West Virginia: „We all had suites. That was the last time we did that. When we got the bill, I thought we'd bought another company!"

Set a frame of reference and avoid surprises.

At his annual strategy meeting, another CEO tries to „lay out the environment we are operating in, the key issues and challenges we will face, our operational plans. I try to set the frame of reference. I want to make it very easy for [our board] to focus." A corollary to that guideline is what James R. Martin, former chairman and CEO of Massachusetts Mutual Life Insurance Company, calls „the fundamental rule" governing CEO/board relationships: „Don't surprise your directors with anything that is important to your company." When one of the top five executives of another company on whose board Martin served left the company, the board members first heard of the departure at a meeting. „This fellow had developed a relationship with some board members and was very highly regarded," says Martin. „We felt that we were entitled to have advance notice of his resignation and to learn the circumstances behind it. Our CEO should have come to us early on, when he first began to lose confidence in that executive. He should have explained it to his board and let it participate in the decision."

Martin was careful to keep his MassMutual board informed of major developments not just to avoid conflicts, but because he believed „you can't do it on your own. You need a group of outside directors in whom you have confidence, to whom you will divulge anything they want to know about the company, on whom you can rely." If it's impossible to keep the entire board up to date, Martin suggests identifying a core group of directors whose interests and involvement you can tap any time, any day.

Develop a culture that fosters mutual respect.

The power partnership between the CEO and the board begins with respect. If you have been successful in structuring your board with competent, independent directors who bring to it special qualifications or experience, you must now work hard to establish a partnership based on mutual respect, in addition to mutual understanding of value systems and broad corporate concerns. William M. Crozier, chairman and CEO of BayBanks, Inc., a Boston-based commercial bank with $10 billion in assets, has surprised some colleagues – and amazed others who do not know him – by recruiting difficult directors to the BayBanks board.

The point, he says, is to surround himself with people whose abilities he respects and who will keep him on his toes. „If you're not playing against good competition," he comments, „you're not going to do much for yourself."

Signs of Trouble

Tender Spots. Violations of unwritten codes of behavior by board members are the tender spots in the CEO/board partnership. They run the gamut from mishandling grapevine information and making indiscreet contacts with company executives, to the more serious offense of using the presumed power of the directorship to exact a favor from another member of the business community. While none of these tender spots may be illegal, all jeopardize the power partnership. They not only compromise the group's effectiveness, they can send shock waves through a company's operations.

The CEO can take several steps to ensure that these tender spots don't fester:

• Make it clear to all directors that they must never talk to the press about company business without CEO counsel and approval.

• Provide formal guidelines that outline corporate norms, policies, and codes of ethics.

• Establish a program of director orientation and continuing education to familiarize outside directors with the company's strategic plans, goals, objectives, and competitive posture.

When tender spots do show up, the quickest impulse often turns out to be the sanest: don't fight surprise with shock. Find out what your rights are and what you can do to right the wrong before it becomes any more crippling.

I was serving as chairman of a privately owned company that Arthur D. Little had launched to develop a process for removing toxic materials from chemical-plant effluents. We had traveled for our board meeting to the headquarters of one of the new company's corporate investors. The topic topping the agenda was the exercise of a call option on this investor to fund our start-up operation, but before we could vote on the call, the chairman of our host corporate investor introduced another motion. He wanted to remove the current management immediately, downsize the company, and relocate operations to his hometown. His motion was immediately

seconded by one of his colleagues.

Surprised by this parliamentary ploy, I called a recess and asked our dissident host investors to leave the room so that we visiting directors could caucus with our attorney in Boston. A half-hour on the telephone gave us the legal opinion we needed: the move was out of order. According to our corporate bylaws, such a drastic motion required advance notice. We invited our fellow investors back in and I told them that we would stick to the bylaws and not recognize the motion to remove current management. As I was about to leave at the end of the meeting, the host chairman invited me into his office and, without fanfare, offered to sell his corporation's shares in the company, thereby signaling an end to our relationship.

Red Flags. The identification and disposal of problem board members is a necessary skill for the office of chairman or CEO. Potential troublemakers range from the diffident to the fierce:

• *The Uncommunicator.* Preoccupied directors are one of the most visible red flags for a CEO to spot. Their unsociability sets them apart. They are best attacked head-on and met face-to-face in a nonconfrontational but serious manner.

• *The Cowardly Lion.* The silence of the cowardly lion should not be confused with that of the uncommunicator. The cowardly lion is a director so in awe of his CEO that he is too restrained to contribute. J.W Barrett, CBE, chairman of R.H. Cole Ltd. in Croydon, U.K., threw a series of social functions to smoke out the cowardly lions on his board. „I was disappointed in their ability to invite important people to these parties," he says. „That gave me a sense that they were not dealing with the proper level of client." The experience led to the departure of three directors whom Barrett felt „weren't substantial in doing their job." His advice: get rid of cowardly lions as soon as possible. „You must have a strong management team," he cautions. „You cannot afford to have passengers."

• *The Diffident Director.* This board member passionately embraces a posture of active disinterest in the company's affairs. He or she typically fails to do his or her homework, arrives late, and consistently devotes the early parts of the meeting to getting his or her departure plans firmed up. Diffident directors also show little enthusiasm for the firm's activities, have few close friends among their fellow directors, and generally appear bored. A director overly concerned with his or her liability as a director and unwilling to take prudent risks is demonstrating other warning signs of the same active disinterest.

• *The Captive.* Often the worst offenders, captive directors never seem to disagree. You can spot them by their nodding heads. One business psychologist suggests that CEOs weed out the captives by never offering just one choice for a significant decision. „Ask whether they would like chocolate or vanilla," he says, „instead of seeing if they want ice cream." Offering alternatives will demand some sort of involvement from every board member, revealing the captives.

• *The Eager Monitor.* This director has an overly zealous posture and intervenes too much in management. The chairman and CEO of a major public utilities company identifies the eager monitors on his board by examining each board member's activity. „I get the directors' attendance report from the corporate clerk," he explains. „This gives me one indication." He also keeps track of which directors call on specific issues, following up those calls with one-on-one meetings.

• *The Senior Citizen.* Entrenched directors can become a burden when they dwell on the past and offer the board much less than what they cost the company in inflexibility and out-of-date perceptions. As many companies have discovered, the answer to getting rid of directors who have stayed too long is enforcement of „statutory senility," a bylaw that forces resignation at a specified age.

• *The Pit Bull.* Never confuse the NIFO watchdog director with the pit bull, who keeps asking questions and probing the company's operations until everyone becomes exasperated. If requests to „tone it down" don't work, he or she should be shown the boardroom door.

• *The Turkey.* Some turkeys lose interest, miss meetings, and doodle their way through the few sessions they do attend. Others, less visible but just as damaging, show up on time, take copious notes, but are out of touch with the company's needs. Still others undergo a change in their professional or occupational status that renders the reasons for their recruitment – their expertise in a specific field, their knowledge of day-today operations, the respect they command in larger financial communities – moot. All are liabilities that the successful CEO is able to manage (read: dispose of).

CEOs must remember that directors have a duty to offer constructive challenges to the issues before them. Their implicit obligation is to ask smart questions. When those questions stop, the CEO should recognize a red flag. This is not to suggest that danger lurks behind every raised eyebrow or silent nod. A director may be reluctant to make a point because he doesn't want to look foolish. But while some red flags turn out to be red herrings, the CEO must be prepared to react with speed and authority when the real thing appears.

Mirror, Mirror on the Wall. Perhaps the hardest red flag to detect is when the CEO is the one upsetting the power partnership. If the CEO doesn't realize that personal chemistry is just as important as every quarterly financial report, he or she will be lucky to have time to correct the misunderstanding. In the case of one young, aggressive, and cocky – but competent – CEO, the combined forces of the directors' tolerance and the CEO's gradual maturation helped dissipate the chemistry problem before lasting damage was done.

The Controlling Interest

Balancing the power partnership between the CEO and the board of directors is the great business puzzle of the next decade. Understand it or be blown away by your ignorance. When the partnership is in balance, independence is equal, dependence is mutual, and obligations are reciprocal. What do you do to achieve this balance, to grasp the controlling interest that leads to success? You don't act militaristically or mechanistically. You use leadership, inspiration, and charisma. You understand that the controlling issue is a people issue.

The CEO/board partnership involves a delicate balance among three kinds of power:

• *The power of control* gives executive management the lead role in the partnership. „If people want a strong CEO to 'fix things,'" says BayBanks' Crozier, „they can't grab him around the collar every five minutes and say, 'Now, you shouldn't do this, and you should do that.' If, in its consummate wisdom, your board has properly selected the person who is going to lead the company out of some sort of corporate morass, it should transfer enough power to let him do the job."

• *Influence power* is the relationship that the CEO, the directors, and the corporation itself have with others who either provide the company with input (suppliers, agents, consultants, and regulators), or are affected by its activity (customers, the media, the local community). It is shared and shaped by the CEO and the board.

• *Appreciative power* describes management's and the board's relationship with a world beyond the realm of business – an area over which they have little control. It can include such imponderables as the current economic climate, intelligence on principal competitors, technological developments, political change, and a wide spectrum of social factors. The board's resources – its members' networks, contacts, and experience – make it the strongest possessor of appreciative power. Through its appreciative power, the board can give the CEO an understanding of factors beyond management's expertise.

When the power of control is supported by influence power and appreciative power, the corporation benefits. But while the interrelationship among these powers may vary per company and situation, the power partnership itself always begins with respect. It is through respect that the balance remains intact.

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