White Paper:

Value-Added Governance

A role of effective governance is to set the course by approving the strategic direction and then to empower the CEO to implement the strategy. Great things could be accomplished if Boards knew their role and concentrated on doing the right things well. This article highlights the four key functions of effective Boards. Doing them well adds value to the organization.

Prepared by:

Grant B. Walsh, MBA, C.Dir.

Managing Partner and CEO

EC Murphy Walsh

gwalsh@ecmurphywalsh.com

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The effectiveness of governance and leadership is not measured by activity but rather by planned outcomes.

Typical governance activity includes Annual General Meetings, Board meetings, committee meetings, approval of medical staff credentialing, and other routine activities.

But, the key purpose for the existence of the Board is to enhance executive decision-making. Therefore, how much of the busyness of the schedule is actually on target? Did the Board merely attempt to justify its existence or did it perform a valuable function for the organization?

There are **four primary functions of the Board** which should be the focus of all Board activity. Theses include:

1. **To recruit, retain, evaluate, and compensate the CEO.**
2. **To approve the strategic direction.**
3. **To provide high level operational oversight.**
4. **To perform the audit function.**

The Chair of a Toronto hospital Board is currently seeking ways for the Board of Directors to add value to the organization. He asks, "beyond the significant costs of a Board and the routine maintenance of governance process, what incremental value is the Board bringing?"

1. To recruit, retain, evaluate and compensate the CEO

The Board's primary functions each have the possibility of adding value. The selection of leadership and the approval of the strategic direction have the greatest potential for making a difference through value-added governance.

If the Board accomplishes nothing else, it must ensure that the organization has an effective CEO. It is very difficult for a CEO to be effective with an ineffective Board and, a Board cannot be effective if it permits inadequate executive leadership.

Supervision at low levels in the organization requires specific knowledge and skill related to the functional area. The CEO requires general knowledge and experience in leading complex organizations. **CEO skills are leadership, governance, strategic thinking, performance**

improvement, human resource management, business development, and finance.

Executive recruitment of CEOs is a specialty deserving of the expertise of a professional. Executive recruiters work with the Board to determine the skills, aptitude and attributes of candidates. Since it is one of the most important decisions to be made by the Board, it deserves priority consideration.

When the Board finds a CEO, the Board's role focuses on strategic direction plus CEO evaluation, compensation and retention. That being said, there are different CEOs for different times and needs of the organization. As in the seasons of a man's life, there is a time for beginnings, growth, maintenance, turnaround and change, and performance improvement. The individual needed for the different phases in corporate life may not be the same person over time. It is the Board's responsibility to ensure that the right individual is present for the right task and time.

In order to retain an effective CEO, it is often necessary for the Board to engage the services of an outside resource that specializes in performance appraisal, compensation and benefits. That individual is able to work with the Board or committee of the Board in establishing the system of performance evaluation, reviewing performance to standard, and setting compensation which is competitive. This system will energize and retain the CEO through rewards and expressed appreciation. Sometimes, it is necessary to develop a compensation system which is intended to keep the CEO for the future. The quantum of the package becomes an investment in leadership. This represents a strong commitment on the part of the Board toward retention.

The CEO is charged with the implementation of the strategic direction which has been approved by the Board. It is therefore appropriate that the CEO is evaluated based upon performance related to that strategic direction.

Organizations have discovered that they get the performance they reward. If profitability is important, reward profitability. If customer and employee satisfaction is important, reward customer and employee satisfaction. Even when the rules of the game are established in advance, it is amazing how many organizations give the reward whether or not the performance has been achieved.

Consistency requires that there are rewards and consequences for performance. If profitability has been stated to be important, don't reward losses. Likewise, when customer or employee satisfaction is unsatisfactory or declining, make sure that accountability for performance is consistently applied.

It has been said, "**We pay on performance and we promote on potential**." In for-profit organizations, bonuses reward on the achievement of goals and, stock options challenge the executive with future potential. Exemplary performance is deserving of reward. Inadequate performance is deserving of consequences.

Ensuring that the organization has effective CEO leadership is the highest accomplishment of any Board of Directors. Once that leadership commitment is made, it is very important that the Board of Directors work in partnership with the CEO to insure that an effective strategy is in place for the future.

2. To approve the strategic direction

Many Boards believe that it is their responsibility to create the strategic direction. There is however a reasonable argument to say that the executive team has more information upon which to make decisions and more "skin in the game." It is reasonable for the executive team to do the groundwork necessary for strategic thinking and bring the components of the strategy to the Board of Directors for review, comment, improvement, and approval.

There are many people who specialize in strategic thinking as a consulting practice service offering. Different consultants claim different methodology in the process facilitation required for strategic thinking. No matter which structure is described, strategic thinking includes vision, mission, values, strategic direction, goals, objectives, tasks, accountability, and timetable.

In organizations where the Board understands its role, it assumes the responsibility to approve the vision, mission, values and strategic direction. As a function of oversight, it is informed regarding goals, objectives, tasks, accountability and timetable. **The Board doesn't need to do everything, but it needs to do a few things right.**

Many times the CEO is in the position whereby he creates the vision and pulls the Board along toward a big picture view. It is a wonderful experience when the Board of Directors and the CEO become so committed to the vision that they lead the organization as a team in pursuit of the vision. It must, however, never be forgotten that the CEO is the one accountable for the implementation of the direction.

3. To provide high-level operational oversight

To provide high level operational oversight is an essential function of a Board which was ignored by organizations caught in the pre-Enron debacle. What was the Board doing? What were Board members thinking? How could they have allowed this to happen?

There is a not-for-profit organization where Board members visit the facility often to drink coffee and visit with members of the staff. Employees seize the opportunity to express topics of dissatisfaction. The Board members in turn raise those issues with management. The individual Board members may not recognize their inappropriate behaviour, but the Chair and Governance Committee should hold Board members to a high standard of conduct.

In the same organization, employee concerns are presented directly as agenda items at Board meetings. The Board members, several of whom are public figures, tend to authorize exceptions to policy in response to direct request. The result is to undermine management authority and to create precedent-setting situations. Where is the Chair?

High level operational oversight is not micro-management as described above. High level oversight provides assurance that the organization is functioning according to plan both in quality and in finance. Is the Board-approved strategic direction being implemented? Does the Board have sufficient knowledge of the business to provide operational oversight? Is the Board meddling beyond its appropriate role?

4. To perform the audit function

The audit function is a fiduciary responsibility of Boards which is currently receiving high profile. The Audit Committee should be composed of independent Directors with financial expertise or financial literacy. The time demands of Audit Committees, as well as the responsibilities, are causing people to think twice before accepting that assignment.

Financial expertise and financial literacy are the terms being used to describe the level of proficiency of Board members regarding finance. Financial expertise describes an individual with a financial designation of CA, CGA, CMA, CPA, etc. Financial literacy describes an individual who is quite conversant and comfortable with financial statements and key indicators of performance. It is a legitimate question for the Governance / Nominating Committee as to whether or not there are any openings for individuals without financial literacy. The skills of individuals without literacy would need to be unique and very valuable.

The Audit Committee must ensure that the organization is doing those things which are legal, ethical, and moral. It must also measure risk so that opportunities evaluated as excessively risky will not be pursued. **Success is rarely achieved with zero risk. Optimized risk brings maximum success.**

How can a Board of Directors add value? A Board adds value by ensuring that the organization has an effective CEO and an appropriate strategic direction. The CEO's performance is evaluated based upon performance related to strategy. It is impossible to accomplish our vision if we have no strategic direction. How can we achieve our objective if we don't know where we are going?

The world of governance has become extremely complex as we learn the cautions regarding fiduciary responsibility and measure the risks of doing business. Benjamin Disraeli said, "The secret of success is constancy to purpose." Constancy to purpose in ensuring effective leadership and a strategic direction are the value-added governance functions which assist the organization in becoming all that it should become.