

THE CORPORATE BOARD

For 29 years . . .
THE LEADING JOURNAL OF CORPORATE GOVERNANCE

REPRINT

The Task Of Board Chairmanship

"Best practices" are developing for independent chairs.

by Gregory T. Carrott

THE CORPORATE BOARD

THE LEADING JOURNAL OF CORPORATE GOVERNANCE

SEPTEMBER/OCTOBER 2008

STAFF

Editor

Ralph D. Ward

Chairman and CEO

Irving A. Leshner III

President and COO

Judith A. Scheidt

Circulation

Ann K. Stocum

Founding Publisher

Stanley R. Greenfield

Editorial Office

The Corporate Board
4440 Hagadorn Rd.
Okemos, MI 48864
Phone: (517) 336-1700
Fax: (517) 336-1705
Web site: www.corporateboard.com

EDITORIAL ADVISORS

Thomas J. Goff—*Founding editor, THE CORPORATE BOARD; executive vice president, corporate reputation and crisis communications, Edelman Public Relations.*

Bayless Manning—*Executive consultant and chairman, Manning Companies; former partner, Paul, Weiss, Rifkind, Wharton & Garrison; former president, Council on Foreign Relations, Inc.; former dean, Stanford Law School; member of various boards.*

Paul W. McCracken—*Former chairman of the President's Council of Economic Advisors, professor emeritus of Business Administration, Economics and Public Policy, University of Michigan.*

Dolores Wharton—*Founder and president, Fund for Corporate Initiatives; member of various boards.*

Vol. XXIX

Recycled  Paper

No. 172

Copyright: THE CORPORATE BOARD (ISSN 0746-8652) is published in January, March, May, July, September, and November by Vanguard Publications, 4440 Hagadorn Rd., Okemos, Michigan 48864. Copyright © 2008 by Vanguard Publications. All rights reserved.

Subscriptions: Available to corporations at an annual cost of \$3,000. This provides delivery of six bimonthly issues to each board member, senior legal and financial officers, and the corporate secretary. Periodicals postage rates have been paid at Okemos, MI and at additional mailing offices.

POSTMASTER: Send changes and all subscription correspondence with THE CORPORATE BOARD mailing label to Customer Service, THE CORPORATE BOARD, Vanguard Publications, 4440 Hagadorn Rd., Okemos, Michigan 48864, (517) 336-1700.

Reproduction: No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopy, recording, or any information storage and retrieval system, without permission in writing.

The Task Of Board Chairmanship

by Gregory T. Carrott

The concept of an *independent* board chairman for U.S. corporations—someone who is neither the current nor retired CEO of the company—is rather new. Yet there are board leaders who make this role workable and effective, both overseas and in the United States. Their challenges and successes offer helpful models as the independent board chair becomes increasingly a boardroom reality.

The debate over whether corporations should divide the roles of chairman of the board and chief executive officer still rages in the United States. It has been resolved in other nations with a decisive shift towards having distinct roles. The fact that the Rockefeller family's two failed attempts to divide the role at ExxonMobil generates so much controversy, and hence, publicity, only speaks to the currency and vibrancy of the debate over what represents best practice.

Chairmen lead their boards, so their role cannot be defined in isolation from the other members. They must adapt their leadership styles to bring out the best in the whole board.

The division of the roles of chairman and of CEO is not a panacea. It cannot change markets or industry economics. It cannot, in itself, right poor decisions or re-make corporations. Moreover, it is not an abstraction. The creation of the separate role of chairman must be right not just for the company but for the person. It is an idiosyncratic courtship with the board and the chief executive as partners.

The role of chair of the board cannot be prescribed from afar. Individuals must establish the role for themselves. Prospective chairmen must ask themselves whether the role as defined makes the most of their own abilities and the capacities of the board.

Chairmen lead their boards, and so their roles cannot be defined in isolation from the other members of the board. Chairmen are *primus inter pares*, but must be concerned with the effectiveness of their boards as a whole. Therefore, they must adapt their leadership styles to bring out the best in their boards. The boards will change over time as the challenges facing their corporations change, and the role of chairman will evolve as he or she gathers experience and confidence, and as the CEO does the same.

Since boards serve as the stewards of shareholders, they must set financial metrics, monitor performance, assure succession and make certain that the corporation's strategy creates the greatest value for shareholders. Whether the board chooses to divide the role of chairman from that of the CEO or not, the chairman:

- Oversees proper functioning of the board and its committees.*

- Sets the agenda for the board, including framing policies and decisions requiring board action.* The chairman must know what decisions have importance, where to shine a light, and how to focus the agenda on the most critical issues.

- Assures the flow of information to the board.* As John Smale, the former chief executive of Procter & Gamble and one-time chairman of General Motors said, directors often "know relatively little apart from what management tells them."

- Makes certain all views are aired, even the disparate.* Raising troubling questions can seem rude, disrupting the collegial atmosphere of the boardroom and creating dissension—but they should be asked nevertheless.

- Acts to relieve pressures within the board and among management.* The chairman has the immense power of being able to listen, and when the occasion arises, serve as an arbiter between differing views.

- Sets high standards.* The chairman inspires and

Gregory T. Carrott is a managing director with consulting firm Cavoure LP, Chicago. [www.cavoure.com]

instigates policy. This sense of mission includes not only the company's tangible objectives, but also its character, the kind of company it is and the kind of company that it aims to become.

Nash-Finch Company, a \$4.5-billion grocery retailer and wholesaler headquartered in Minneapolis, provides an example of how chairmen shape their role, the board and the corporation.

Bill Voss succeeded Allister Graham as the chairman of the board of Nash-Finch in May 2006. A Canadian, and former CEO of a comparable grocery wholesaler and retailer, Allister Graham was well versed in the politics of boards and the balancing of the roles of the chairman and chief executive officer.

Graham needed all his skills to keep the board at Nash-Finch together through a difficult turnaround, and then a Securities & Exchange Commission investigation of vendor rebates that saw the company's share price halve in a month. While the SEC fully exonerated Nash-Finch, the years of turnaround, followed by the SEC probe, exacerbated frictions on the board. The directors grew weary.

In the end, with success, Allister Graham would represent the archetypal non-executive chairman for many on the board—the hidden hand that steers the ship through roiling waters.

When Graham retired, a chairman with differing experiences, perspectives and personality replaced him. Bill Voss had been on the board of Nash-Finch for eight years before he became chairman. He had been the CEO of McCain Foods in the United States before launching a successful private equity fund, and it was his experience in private equity, perhaps more than anything else, that caused him to look at the Nash-Finch board so differently than Allister Graham.

The boards of companies owned by private equity firms tend to be smaller, with only four to eight directors versus the 10 to 14 directors at most large public companies. Furthermore, "private equity firms often recruit directors with extensive operating experience in the same industry," as the *Harvard Business Review* noted, and expect directors "to spend much more time on company business than do the directors of

public companies."

Applying what he had learned from private equity, Voss sought shareholder resolutions to shrink the board to as few as seven members and to eliminate staggered terms. Both resolutions passed this May. Yet even before the resolutions had passed, he worked with the board to restructure its committees and to establish clearer financial metrics for the company. The board made a dramatic shift under Voss from being focused on the process of governance to a focus on the business.

The private equity model of an active chair and board may work best with a smaller, more narrowly focused company where the CEO welcomes strategic assistance from a knowledgeable chairman and regular consultation.

Yet Nash-Finch is not alone in the shift that it undertook. In July, UBS announced that it would replace one-third of its board of directors. This makes room for up to four newcomers with significant financial experience to help guide Europe's biggest casualty of the U.S. sub-prime crisis with losses of about \$38 billion. Peter Kurer, the new chairman of UBS, wants to strengthen the board with independent members bringing financial and audit experience, and thus, to build the capacity of the board to engage management more directly.

A non-executive chair can do difficult things that a chairman and CEO might not do, like more quickly counsel wavering management, or force out underperforming directors.

A lead director would have been unlikely to force such changes at either Nash-Finch or UBS. Private equity controls boards and agendas for a reason. A non-executive chair can do difficult things, things that a chairman and CEO might not do, like more quickly counsel wavering management, or force out underperforming directors.

More to the point, however, a lead director cannot set a clear agenda. He or she has little power to place or to take away focus. The best a lead director can do is to advise the chairman and chief executive.

Management sets the agenda through the CEO. “Management writes the board agenda. We tend to look only where they shine the light,” complained one director to Booz & Company. With an outside chair, the board itself controls the agenda.

As one chairman quipped, “Lead directors are not paid enough to address tough issues.”

Also, as an influencer or advisor, a lead director cannot call a meeting even to address a problem. Once again, the lead director must coax his chairman into action. However, a non-executive chair is more likely to force a CEO to step up and address issues before they become problems. The chair is also far more likely to seek outside expert opinion about a particular issue, whereas a CEO will think that doing so may be seen as a form of weakness, or fear that the outside opinion will conflict with his strategy.

Finally, as one chairman quipped, “Lead directors are not paid enough to address tough issues.”

A slow-paced shift toward separating the roles of the chairman of the board and the CEO may be underway, particularly at troubled companies. The model of using a lead director may be solely transitional.

Having a separate chairman is still far from the norm, though. Twenty-one companies that are part of the Dow-Jones Industrial Average combine the roles, seven have the former chairman and CEO serving as chairman, and only two have clearly decided to divide the roles. Just 13 percent of the S&P 500 has a truly independent chairman, according to one counting, compared with virtually all the United Kingdom’s FTSE 300.

It is still more common in the United States to see the appointment of a chairman as a means of creating continuity with a new chief executive. For example, many expect George David to remain as chairman of United Technologies for several years as Louis Chenevert settles into his role as CEO.

The naming of a separate chairman of the board seems increasingly common among companies ex-

periencing difficult times. For example, Motorola moved to bolster investor confidence last spring by naming David Dorman, a telecom industry executive, as its non-executive chair. Dorman spent nearly three decades in the U.S. telecom industry, including stints at Sprint, Pacific Bell and SBC Communications. He served as AT&T’s chairman and chief executive until 2005, helping to restore morale and reviving the company’s flagging fortunes.

Dorman joins other non-executive chairs named at large companies this year:

□ John E. Pepper Jr., the former chief executive of Procter & Gamble, became the chairman of the board of The Walt Disney Company.

□ Stephen R. Hardis, the former chief executive of Eaton Corporation, at Marsh & McLennan.

□ Stephen E. Frank, the former chairman, president and CEO of Southern California Edison, at Washington Mutual.

A decision to separate the roles of chair and CEO is not one of right or wrong, but of what is best for the company at a specific time.

Too often, critics portray the decision to separate the role of chairman of the board from that of chief executive officer as a decision of right versus wrong. Nothing could do more disservice to the decision. Such decisions should be about what is best for the company at a specific time and under its own unique set of circumstances.

Some situations clearly warrant or lend themselves to the naming of a separate chairman. The board may have named a less experienced CEO, for example, or when the board appoints a new CEO from outside the company.

However, the debate about whether a retiring chief executive should stay on as chairman of the board is a complex one. The ideal situation, most admit, would be for the retiring CEO not to become the chairman, and in fact, not to stay on the board at all. “Yet there are circumstances where it might be the right thing for the company,” says Bruce Blythe, an advisor to family ownership interests. “If the company was

in the midst of a takeover, for example, a strategic restructuring or downsizing, it might be that the continuity of the former CEO staying as chairman would be helpful. Such things should be determined by the situation and good judgment, however, rather than by dogma.”

Regardless, being successful as a chairman and being successful as a CEO require different skills, and it is a rare person who can be superb in both roles. The present and the future do not run in harness, and rarely should such conflict take place solely in a single person’s mind. If one person tries to do both, something likely suffers by default.

There is always more to accomplish than one person can handle, and splitting the tasks of running a corporation makes this easier. As John Whitehead, the former co-chairman of Goldman Sachs said, “One man rule is a bad idea.”

This is especially true of a large international company with operations spread throughout the world. If the CEO spends disproportionate time on government or investor relations, international travel or even governance, he probably neglects the business. The reverse is also true. No matter what, dividing the roles between chairman of the board or chief executive officer allows the company to appoint leaders with different strengths and perspectives and draw on a broader range of attributes—the classic outsider and insider. A good example of this might be how Vodafone settled down once Sir John Bond became chairman.

At the end of 2005, few gave Arun Sarin an even chance of surviving as the CEO of Vodafone. Most expected the board’s incoming chairman, Sir John Bond, to sack him. Instead, Bond backed him.

Decent results helped. After a long series of disappointments, Sarin began to deliver results comfortably ahead of market expectations. Yet more important, Sarin’s judgment, which appeared questionable only months earlier, proved correct. He was absolutely right, for example, to hold onto Vodafone’s 44 percent interest in Verizon Wireless against calls to divest. If he had done what the hedge funds clambered for, he would have found himself pillared for selling at too low a price.

“Much of the problem Mr. Sarin had with perceptions lay in turning overblown expectations to reality,” *The Independent* wrote, “and a dysfunctional board apparently intent on knifing each other to death. But these problems seem now to be in the past” thanks to Sir John Bond.

Critics of separating the role of chairman and CEO often point to Enron and WorldCom as examples where the model failed to prevent the demise of the companies and shareholders lost billions of dollars. It is important to remember in both instances, that Kenneth Lay and Bernie Ebbers were the former CEOs and maintained a controlling presence. They made it impossible for either the board or the management to look afresh at the company.

If a company chooses a separate board chair, it would be best if that person is the former CEO of another company, and preferably brings knowledge of the industry.

Running a board is a damned difficult task, a task most often learned by observing and doing. John Nichols, the former chairman and CEO of ITW, quips that a class in small group dynamics that he took as a Harvard undergraduate best equipped him to chair the board of ITW, though that is not a course at most business schools.

If a company chooses to have a separate chairman of the board, it would be best if the individual were the former CEO of another company with long and varied experience on both boards and their committees. Ideally, the chairman would have served on the board of the company in question, but not necessarily. In Europe, it is not unusual to see chairmen recruited from the outside, as was the case with Royal Dutch Shell’s appointment of Jorma Ollila.

It is also preferable that the chairman bring knowledge of the industry. The quest for directors from different industries has been partly driven by the desire to have a broad set of opinions in the boardroom and partly by regulatory requirements.

One hurdle faced by banks in both the United States and Europe in addressing sub-prime mortgage issues,

for example, is that it is almost impossible to recruit outside directors with industry expertise. As the *Financial Times* has noted, an unintended consequence of Sarbanes-Oxley has been that conflicts rule out the most knowledgeable candidates. Knowledgeable directors, particularly knowledgeable chairmen, can better challenge the thoughts and actions of management, and thereby, raise expectations.

Additionally, the chairman must have the capacity for long hours, perhaps as many as 100 days a year for large companies. A chair must also be capable of acting with few if any staff. It is not a ceremonial role.

The chairman of the board needs to have high conceptual skills and an ability to see what others cannot. If he is to inspire others, he must also possess the self-confidence and patience at times to leave action to them. A chairman should act only when necessary. Otherwise, he should rely on someone else.

One chairman likens the role to that of a movie director who orchestrates a thousand things behind the scenes but never appears on screen. To accomplish this means forging a strong working relationship with the chief executive officer. This ability to form strong personal relationships with the other members of the board, with the CEO, and with management enables the chair to accomplish his tasks. The potential for conflict exists, but it is more likely to be a conflict between two human beings that must be resolved between them, rather than a conflict inherent in the separation of the roles.

This is why the analogy of a movie director works so much better than that of a coach and a quarterback, which some use. A coach can always change the quarterback in the third quarter. That is not possible for a director who must make the relationships work, no matter how difficult.

The chairman of the board must also foster open communications and must work hard to develop trust. Non-executive directors are more likely to frankly discuss their concerns about the business or management team with a non-executive chairman than with a combined chair and CEO when the

discussion may become personal. Likewise, if the non-executive chairman is the former CEO, it might be more difficult to have that dialogue than with a knowledgeable, but still distanced, outsider.

The chairman needs to be a strong mentor, and the board must see in the appointment the clear possibility that the chair has the promise of building an effective working relationship with the CEO. Like the other behaviors expected of a board chair, the ability to coach and mentor can be verified through references. Someone who has shown the ability to develop others will be more likely to develop a strong working relationship with the CEO and to develop the talents and skills of the other directors, too.

What matters most is the caliber of the person who holds the chair, not the structure of the role.

In many ways, chairmen achieve their authority through wisdom, which comes from knowledge, experience and tempered judgment, but also knowing when to listen, when to speak and when to act. Wisdom generates respect, and thus, provides chairmen with a platform to lead and inspire.

I once served on a charitable board, chaired by William G. Caples, an Inland Steel executive who went on to become the president of Kenyon College. Bill commanded the respect of everyone in the room. He was a wonderful man—bright, direct and diplomatic—and earned our admiration and affection.

He has passed away, but more than once over the years in talking with others who served on the board, I have heard, “I wonder what Bill . . .” or “if only Bill . . .” Ultimately, what matters most is the caliber of the person who holds the chair, not the structure of the role. ■

Author's note: Some time ago, Sir Adrian Cadbury helped me formulate a whitepaper on how best to divide the roles of chairman and CEO for a major U.S. client. I used several paragraphs from that paper in writing this article, and even with the passage of time and editing, the thoughts and words may be as much Sir Adrian's as mine.

Gregory T. Carrott

CAVOURE LP

Advisors in Executive Search

190 South LaSalle Street, Suite 500 ■ Chicago, Illinois 60603

Telephone: (312) 957-4151 ■ E-mail: carrott@cavoure.com