Principles of Corporate Governance

By

I n its 2004 .Principles of Corporate Governance , . the . international . Or- ganization . for .Economic . Cooper - ation . and .Development . (OECD) . describes . corporate . governance . as .“a . set . of .relationships . between .a .company’s . management, .its . board, .its . shareholders . and . other . stakeholders.” .At . first . glance . this . statement . isn’t .particularly . earth . shattering. .If .anything, .it’s . painfully . ob - vious. . But .if .you .focus .on .the .word .“relation - ships” .— . a .word . that .lies .not . only . at .the . heart .of .the .sentence .but .of .corporate . governance .as .well .— .things .get .more . complicated. .Why? .Because .relation - ships .among .these .groups .are .anything . but .simple. .They’re .what .negotiation .ex - perts .call .“mixed- motive” .relationships, . and .they’re .exceedingly .prone .to .break - down .and .failure. . Consider .a .recent .Booz .Allen .Ham - ilton .study .of .the .world’s .2,500 .largest . publicly .traded .corporations. .Calling . record-high .turnover .among .executives . “the .new .normal,” .this .study .reports .that . forced .turnover .among .CEOs .rose .318% . since .1995. .In .2006, .one .out .of .ever y . three .CEOs .left .involuntarily. .Nearly . a .quarter .of .the .forced .departures .fol - lowed .from .conflicts .w ith .the .board . — .up .from .2% .in .1995. .In .each .case, . shareholders .ended .up .footing .the .bill. These .stat ist ics .reflec t .at .a .macro . level . pervasive . turmoil .at .a .human . level . — . turmoil . that .can .only . be .understood . by .looking .at .the .shifting .relationship . between .boards .and .CEOs. Two .cases .I .studied .illustrate .the .point. . In .the .first, .a .young .entrepreneur ial . CEO .of .a .fast-growing .firm .was .under . siege .from .her .board .after .an .especially . tumultuous .year. .While .the .firm’s .re - sults .were .still .strong, .the .board’s .activ - ist .chairman .quite .rightfully .worried . about .the .organization’s .longer-term . health. .Why .was .there .so .much .turn - over .in .the .higher .ranks? .Why .wasn’t .she . sticking .to .the .firm’s .strategy? .Was .she . too .volatile .and .opportunistic .to .take . the . organization . to .the . next . level? . These . are .exactly .the .kinds .of .questions .boards . are .charged .with .asking .and .CEOs .are . charged .with .answering. . Chairman’s tirade Yet .that .isn’t .what .happened. .Instead, . having .privately .reached .his .own .conclu - sions, .the .chairman .more .or .less .subtly . launched .one .criticism .after .another .at . the .CEO. .Feeling .undermined .and .out - raged, .the . CEO . retaliated . in .kind, .coun - tering .each .“attack” .with .one .defensive . maneuver .after .another. .Unable .to .see . eye-to-eye, .each .brought .the .worst .out . in .the .other, .making .it .impossible .for . them .to .fulfill .their .governance .respon - sibilities. .Indeed, .far .from .creating .value . for .the .organization, .their

.relationship . was .systematically .destroying .it. .Had .the . two .not .had .the .good .sense .to .get .help, . the .CEO .might .easily .have .ended .up .as . just .another .statistic. In .the .second .case, .just .the .oppo - site .happened, .but .with .similar .results. . Despite .mounting .worr y .over .an .18- month .period, .the .board .members .of . a .well-known .manufacturing .company . were .unable .to .stop .the .firm .from .slip - ping .ever .further .into .the .doldrums. .The . company's .CEO, .who .fancied .himself .a . master .at ."managing" .public .boards, . 64 directors & boards endnote The heart of the matter Good governance depends on good relationships between the management and the board. Sounds simple and straightforward? It's not. By diana McLain smith Continued on page 63 Diana McLain Smith is the author of Divide Or Conquer: How Great Teams Turn Conflict into Strength (Portfolio/Penguin USA) and a part- ner at the Monitor Group, a global manage- ment consulting firm. Her Web site is www. dianamclainsmith.com. Unable to see eye-to-eye, the chairman and the CEO brought the worst out in the other. fourth Quarter 2008 63 endnote

 spent .days .every .quarter .preparing .air- tight .presentations .that .anticipated .every . possible .question, .challenge, .or .criticism . that .might .come .his .way. .The .board, .dis - couraged .by .the .CEO's .pat .presentations . yet .loathe .to .interfere .in .his .management . of .the .firm, .tacitly .complied. .It .wasn't . until .the .firm's .stock .price .collapsed .that . the .directors .finally .took .action, .firing . the .CEO .and .half .his .team. In .an .ideal .world, .cases .like .these . would .be .the .exception, .not .the ."new . normal." .In . that . ideal . world, .boards . and . CEOs . would . jointly . define .their .compa - ny's .strategic .challenges, .jointly .identify . the .information .needed .to .address .them, . jointly .assess .the .CEO's .developmental . needs, .and . jointly . ensure . accountability . for .results. .In .the .real .world, .this .hap - pens .all .too .rarely. .Why? B e cause .we .have .our .attent ion .so . squarely .focused .on .individuals .— .on . their .personalities, .their .performance, . and .their .potential .— .that .we .pay .little .

attention .to .the .quality .of .the .relation - ship . between . a .company’s . management . and .its .board. .Yet .my .studies .suggest .that . these .relationships .have .a .profound, .even . decisive .impact .on .a .CEO’s .personality . and . performance . and .whether . he .or .she . can .realize .a .firm’s .full .potential. . The .bottom .line .is .this: .good .gov - e r n a n ce .d e p e n d s .o n .g o o d .re l a t i o n- ships. .When .relationships .break .down, . neither .b o ards .nor .CEOs .can .effe c - tively .fulfill .their .governance .duties. . As .boards .continue .to .redefine .their . roles .and .become .more .active, .it’s .im - per ative .that .the y .g ive .relationships . the .time .and .attention .the y .require. . W h e n .t h e .e n t r e p r e n e u r i a l .C E O . a n d .h e r .b o a r d .c h a i r .d i d .j u s t .t h a t , . they .successfully .worked .together .to . change .the .p olar ized .dynamics .that . were .undermining .her .ability .to .lead . and .their .collective .ability .to .govern. . A .year .later, .the .problems .that .so . wor r ied .the .chair man .and .thwar ted . t h e .C E O .w e r e .n o .l o n g e r .a n .i s s u e , . a n d .t h e .t w o .w e r e .a b l e .t o .p u t .t h e i r . a t t e n t i o n .w h e r e .i t .m o s t .b e l o n g e d : . o n .g r o w i n g .t h e .e n t e r p r i s e . . . . ■ The author can be contacted at dianamsmith@comcast.net. Heart of the matter Continued from page 64 The relationship with the board has a decisive impact on a CEO’s personality.