

Board Effectiveness Insights

Chapter 2 / Version 2.0

February 2004

FOCUS

BOARD EFFECTIVENESS PARTNERS (BEP) collaborates with directors and CEOs to objectively analyze and improve the effectiveness of their boards.

INSIGHTS

We publish *Board Effectiveness Insights* periodically to encourage dialogue on strengthening board effectiveness. We welcome your suggestions, thoughts, and agreement or disagreement. Please visit www.bepartners.com for more details and other chapters of *Board Effectiveness Insights*.

A METHODOLOGY: STRENGTHENING BOARD EFFECTIVENESS

CEOs and board leaders recognize that an effective board must be managed and nurtured as a corporate asset and competitive differentiator. Periodic assessments of board effectiveness and governance quality are particularly important whenever:

- ▶ CEOs, board chairmen, or board committee chairs are in transition
- ▶ Large-scale mergers, joint ventures, or other strategic initiatives are implemented

Board Effectiveness Partners (BEP) is frequently asked to summarize the critical steps we recommend in board-strengthening initiatives. Although each board is unique and requires a customized approach, this chapter of *Insights* offers a starting point for understanding our process.

Introduction

In establishing a partnering relationship with a client, BEP has found that the following criteria are essential for success:

- ▶ **Commitment.** BEP accepts engagements only when the CEO and board leadership agree to an objective assessment of the board.
- ▶ **The BEP Methodology.** BEP has developed and refined an approach to partnering with clients: from analyzing the current status of board effectiveness and governance quality, to planning a transition strategy and timeline, and then guiding the implementation of necessary change.

While recognizing the uniqueness of each board, we offer the following actual (disguised) example of two boards that were combined as a result of a merger, to help illustrate how BEP's partnering relationships and methodology work in "real time and the real world."

- ▶ Twenty-five board members remained in a contentious post-merger environment. Two former CEOs and two former chairmen served as directors.
- ▶ Although he had served on one of the merged boards, the new chairman had not previously been a chairman.
- ▶ The following methodology was effective in identifying the critical issues and providing a framework for building an effective combined board, as well as a strong relationship with new management.



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A Methodology: Strengthening Board Effectiveness

A BEP Managing Partner, often with a BEP Partner or Alliance Partner, conducts all interviews as well as ongoing collaboration with the CEO and board leaders. Confidentiality is assured.

For the merged boards, the interviews involved:

- ◆ Discussions with all board members for one to two hours each. The directors set the interview length.
 - ◆ Over 30 interviews with the CEO and his direct reports and others critical to the board's success, including investors, public accountants, outside attorneys (due to significant litigation exposure), and industry analysts.
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A prologue: Today a new chairman and the CEO look back, and then ahead:

- ▶ Three original directors and the CEO continue to serve a completely transformed enterprise and board.
- ▶ Four new directors are focused on partnering with the CEO to ensure the enterprise's success.

BEP Methodology

BEP employs a five-step process when partnering to strengthen board effectiveness. BEP's approach is tailored to the unique needs of each board.

Step 1: Background Analysis. Develop a hypothesis and interview guide. Review and analyze 24 to 36 months of the following materials:

- ▶ 10-K and annual report disclosures and notes
- ▶ Stock performance compared to indexes and competitors
- ▶ Corporate governance ratings from regulators and independent sources
- ▶ Board briefing books, agendas, and minutes
- ▶ Financial performance vs. plan and competition
- ▶ Reports from industry and credit analysts
- ▶ Communications involving public accountants, regulatory agencies, management, and employees
- ▶ Communications involving customers, investors, vendors, and partners

Step 2: Interviews, Analysis, and Collaboration. Define opportunities and options for change and calibrate the board's and management's capacity for change.

- ▶ Interview directors, management, investors, and other key parties
- ▶ Collaborate with leadership to explore opportunities to implement change and assess previous attempts at change—whether successful or unsuccessful
- ▶ Analyze and prioritize the opportunities for implementable change, in a collaborative process

Step 3: Opportunity Assessment and Change Design

- ▶ Assimilate interview and research feedback
- ▶ Develop preliminary recommendations and define implementation obstacles
- ▶ Create a discussion draft of a multi-year timeline for continuous improvement
- ▶ Develop "Q&A" and "talking points" for directors and management that answer predictable questions, including: Why change? What will change involve? When will the change process begin and end?

Step 4: Finalize Plan for Change

- ▶ Review and refine recommendations
- ▶ Establish a timeline for change and define strategy implementation obstacles
- ▶ Plan progress reviews
- ▶ Refine "Q&A" and "talking points"

Step 5: Ongoing Improvement. After implementing significant change, the merged board continues to review and improve its performance.

- ▶ Recognize that difficult, worthwhile, and continuous change involving senior and talented leaders demands time, tenacity, and creativity

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A Methodology: Strengthening
Board Effectiveness

Triangulating on truth is key when correlating individual perceptions with facts and research focused on:

- ◆ best practices
- ◆ lessons learned
- ◆ competitive and benchmark data
- ◆ BEP's partners' years of experience with board successes and failures

To ensure the validity of the information BEP and our clients work with, we always attempt to corroborate "truth" (wherever differing opinions or interpretations occur) by obtaining input from a variety of sources, a process we refer to as **triangulating**.

In Depth: Interviews, Analysis, and Collaboration

Interviews, analysis, and collaboration are central to BEP's partnering with CEOs, chairmen, board leaders, and principal investors. The following outline highlights BEP's perspective and the typical questions asked during the Step 2 interviews and BEP's analysis focused on strengthening the merged board.

Priority Questions for Board Members

- ▶ How does, and should, the board work?
- ▶ What is your board role? What should it be?
- ▶ How do you provide guidance to the CEO, chairman, and your board colleagues?
- ▶ Is the board effective? How, and when, should it change?

BEP's Focus

BEP correlates opinions and facts with our ongoing best practices research, governance quality intelligence, and experience in a process we call **triangulating on truth**. (See sidebar.)

BEP explores individual perceptions of the board's effectiveness and the options and capacity for action. The following typically guides BEP's interviews:

- ▶ Explore the interviewee's perspective on the effectiveness of each board member and the board at large.
- ▶ Assess culture and talent gaps and the confidence that board members have in each other. Examples: "Let's talk about the board members . . . (never by name!). How can the directors be better educated? How could their performance be improved? Is there a process or procedure to evaluate board and director performance? How do evaluation results impact the board's effectiveness?"
- ▶ Probe to understand how well each board member understands the company's strategy and competitive horizon.
- ▶ Explore how complex board decisions are made by reviewing a few specific decisions made by the board. Examples: "How did the board select and manage the outside auditor? How did the board decide on the merger? Who was involved in the dialogue? How did the board decide on compensation, including cash, stock, and perks, as well as incentives and termination agreements? Why?"
- ▶ Discuss the need to periodically evaluate succession plans. "Who will succeed the CEO, chairman, board members, and the CEO's direct reports?"
- ▶ Explore how directors educate themselves about the company. Recognize that there may be thousands of strategic initiatives under way worldwide in a large global company. How do directors get the "real truth"?
- ▶ How well do directors understand the 10-K and annual report disclosures and notes?
- ▶ Do the directors understand the company's technology, financials, talent, brand, and R&D resources compared to the existing and evolving competition?
- ▶ "How, and at what cost, will the company survive if its IT infrastructure fails?"
- ▶ "How much time do you, and can you, devote to the board? How involved, competent and committed are your fellow board members?"
- ▶ "How is the board's agenda set? Do the board meetings effectively address the issues that 'really' matter for the company's sustainable success?"

BOARD EFFECTIVENESS PARTNERS

CLIENTS

The following is a partial list of the organizations served by BEP's Managing Partners, as consultants or executive leaders, prior to or since forming BEP:

American Express
American International Group
American Greetings
Aon
Apogee Enterprises
AT&T
Bank of America
Bell Laboratories
Boeing
Bristol-Myers Squibb
Cap Gemini Ernst & Young
Cell Genesys
CIENA
Citigroup
Continental Grain
Corning
Covisint
EF Johnson
Fulcrum Analytics
Genzyme
Getronics
Greenwood Publishing Group
Harmon Solutions Group
IBM
Independence Community Bank
Johnson & Johnson
J.P. Morgan Chase
Kauffman Foundation
KeySpan
Kodak
LexisNexis
Lifetime Television
Loehmann's
Lucent Technologies
Lydall
Marsh & McLennan Companies
Menasha
Millennium Pharmaceuticals
National Institutes of Health
Orbiscom
Pfizer
Reed Elsevier
SAIC
Seisint
Stanley
The New York Times
TheStreet.com
The Wharton School, Univ. of Pennsylvania
United Technologies
Universal Studios
Verizon
Veronis Suhler Stevenson
Xerox
Yankelovich

Our Firm

Board Effectiveness Partners (BEP) collaborates with directors and CEOs to objectively analyze and improve the effectiveness of their boards.

BEP's business mission is to serve as the catalyst to enhance board effectiveness and governance quality—enabling directors and CEOs to guide their companies to continuously improved performance and competitive superiority.

Our Value

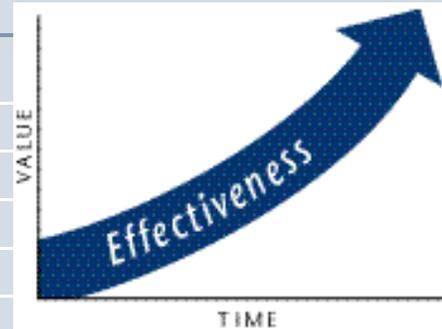
Continually Enhancing Performance

BEP Review and Implementation

Partnering with BEP

Committing to Effectiveness

Compliance



Managing Partners

BEP's managing partners have an average of 30 years of experience as CEOs, board leaders, or consultants. With career credentials from manufacturing to financial services, and skills ranging from strategy design to implementing change, we provide the breadth and depth of professional background essential to strengthening board effectiveness. Our managing partners nurture relationships and work with senior, respected consultants to quickly field teams to strengthen governance quality.

KEVIN ENGLISH has devoted his career to leading business units, companies and boards and has improved corporate performance as a CEO and Board Chairman.

JOHN MCCREIGHT has dedicated over 35 years to consulting and partnering with CEOs, senior management, boards and investors in defining and implementing large-scale strategic change.

MARK SCHNEIDERMAN is a senior-level human resources professional who has held corporate leadership roles, and partnered with senior leadership and boards as a consultant, to facilitate strategy implementation and change management.

Alliance Partners

BEP nurtures relationships with over 100 Alliance Partners who exemplify preeminence in their fields and complement our core competencies. Alliance Partners strengthen our capacity to improve board effectiveness and governance quality.

Research & Operations Center

Our Research & Operations Center (ROC) professionals are linked worldwide to our clients, Alliance Partners, industry experts and the academic community. They focus daily on monitoring board effectiveness facts, opinions, successes, disappointments, lessons learned, and best practices.