

Corporate Boards That Create Value

Governing Company Performance
from the Boardroom



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Advance Praise for *Corporate Boards That Create Value*

“In *Corporate Boards That Create Value*, Carver and Oliver offer totally new insights into an old topic. This rare and remarkable book provides a logical framework for governing in an efficient, accountable manner. The authors’ easily understood and brilliantly explained methodology shows how directors can provide complete accountability to shareholders and also empower the management of the enterprise.”

—James Gillies, Ph.D., Professor Emeritus, Schulich School of Business, York University, Toronto, and author of *Boardroom Renaissance: Power, Morality and Performance in the Modern Corporation*

“The message of John Carver’s and Caroline Oliver’s book is clear—governance is the job of the board. It must be the key focus of the board and under its direction and control. By actively implementing the road map provided by the authors, progressive boards will be able to demonstrate that they are committed to promoting a culture of good corporate governance.”

—John Hall, FAICD, CEO, Australian Institute of Company Directors

“Carver and Oliver give us a clear, practical, and effective model for governance. This is a model that enables boards to fully grasp their role as trustees and yet frees management to achieve the ‘ends’ the ownership wants and deserves. Must reading for board members and executives.”

—Jack Lowe, Jr., chair and CEO, TDIndustries (top ten in *Fortune’s* 100 Best Companies to Work for in America, 1997 through 2002), Dallas

“*Corporate Boards That Create Value* is a veritable tour de force in the area of corporate governance, a major breakthrough in board leadership. In my opinion, the title Chief Governance Officer and the special illumination of the role and responsibility of those who would serve in that position are the greatest furtherance of servant leadership since Robert K. Greenleaf wrote the original essay, ‘The Servant as Leader.’”

—Jim Tatum, CEO, Tatum Motor Company, community college leadership consultant, and former chairman of the R. K. Greenleaf Center for Servant Leadership

“Carver and Oliver provide a unique and innovative model for corporate governance. What’s even more remarkable is that the structure of the model allows corporate governance policy to be crafted to tackle the real-life, day-to-day issues facing both boards and management. In so doing, the model provides all stakeholders the comfort of knowing that a rationally structured approach exists for addressing corporate governance and, thereby, fiduciary responsibilities.”

—Christine Jacobs, chairman and CEO, Theragenics Corporation
(Forbes’ America’s 200 Best Small Companies, 2001), Duluth, Georgia

“Carver and Oliver will challenge your most fundamental beliefs about corporate governance—a true breakthrough in thinking. Investors, directors, and executives should heed their message.”

—Dana R. Hermanson, C.P.A., Ph.D., director of research, Corporate Governance Center, Kennesaw State University, Kennesaw, Georgia

Corporate Boards That Create Value

John Carver
Caroline Oliver

Foreword by Sir Adrian Cadbury

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Foreword

It is a privilege to be invited to write a foreword to a book that should change our thinking about boards. *Corporate Boards That Create Value* has to be read with an open mind, casting aside the accumulation of accepted practice and approaching the whole subject afresh. We have waited long for a book that analyzes the role of boards from first principles. John Carver and Caroline Oliver have now filled this gap and done so with patient lucidity. As they say, “significant advances in governance will come about only from rethinking the very nature of the board job.” The rest of us involved in matters of corporate governance have taken boards as we found them, and sought ways of making the board systems, which were already in place, more effective. The resulting focus on governance and the emergence of codes of best practice have seen a measurable improvement in board effectiveness, powered by market forces. A significant advance, however, in the view of Carver and Oliver, demands a new governance model and not simply further refinements to the existing model.

The Policy Governance model fills that bill and thereby makes a fundamental contribution to the cause of better governance. Each element of the new model is firmly based on logic. As a result, all the elements fit together to form a single, coherent governance structure. For the first time, we are being offered a fully integrated and coherent system of governance. The role of the board is to govern on behalf of the owners. The board alone, therefore, determines the ends of the enterprise, its essential purpose. It does so in the light of the expectations of the owners and

acting for the owners. How those ends are achieved is the responsibility of management and involves a choice of means. Means are delegated to management, but within bounds carefully set by the board. Deciding which means are not acceptable is a crucial board responsibility because most of the damage to corporate reputations arises from mistaken means. The clearer the board's policy guidance, the greater the freedom of the executive to use his or her ingenuity and skill to deliver agreed results and the greater his or her ability to act quickly, without reference back to the board, always provided that action is within the bounds.

Boards, as we know them, face the problem of where and how to draw the line between direction, which is the task of the board, and management, which is the task of the executive. The temptation is always for direction to seep into management. Running a business is more immediate, more gripping, and more easily grasped than determining the purpose of the business and setting the framework within which the business has to be managed. The consequence is that boards tend to look inward at management rather than outward to the owners and how best to govern on their behalf. Once a board has defined ends and bounded means, it has established an unequivocal basis for the separation of board and management roles.

The Policy Governance model that is thoroughly worked through in this book represents a significant advance in management thinking. Not only is the model logical and integrated, it is also as near a universal theory of governance as we at present have. It appears applicable to most types of governing bodies in most parts of the world. Its universality provides a benchmark against which to measure the quality of existing governance models of all kinds. I accept the authors' warning, based on experience, of the importance of installing the Policy Governance model as a whole and not introducing it in stages or using it to patch an existing system. Nevertheless, the book does point out which elements in the model could be drawn on to bring greater clarity of purpose and of roles to the structure and workings of any board. Even if board

members do not currently envisage adopting the model, the thinking that lies behind it is relevant to any group endowed with governance responsibilities.

A move to the Policy Governance model looks straightforward because the logic behind the model is so clear. Precisely because it is driven by logic, it is uncompromising and cannot be bent to fit personalities in the way we usually treat our organizational structures. It requires a disciplined approach, and discipline is uncomfortable, perhaps especially for those of us used to moderately anarchic board procedures. The board has to discipline itself to deal with every issue through policy. This is considerably more demanding than making or agreeing to decisions as they arise and meddling in management from time to time. Thinking is hard work. Directors working under the Policy Governance model have to construct a framework that both gives the CEO a clear remit over the results to be achieved and sets the limits within which those results are to be achieved. The board has both to prescribe and to proscribe, as the authors point out.

Boards that follow the model are clear about their role, and the confusions referred to earlier over the respective provinces of board and management are resolved. To underline the governance role, Carver and Oliver suggest that whoever chairs the board should be called the chief governance officer (CGO). Although it is hard to change traditional titles, this concept is a powerful one, and one whose time has come. The essential point is the stamp that it puts on the role of the board and of those who chair the board. They are there to govern. By referring to the chair as the chief governance officer, that post is firmly differentiated from that of the chief executive officer.

The next challenge is whether the CEO can also be the CGO. The logic of the model seems to me to add weight to the case for the separation of roles. The more precisely the functions of the board and of management are divided, the more logical it becomes for them to have different heads. Indeed it would be an advantage to a CEO to have someone whose role is as distinctly different as

the CGO's role is in the new model with whom to share and debate thoughts, ideas, and concerns. A difficulty with the usual split of duties between chairs and chief executives is that there remains enough common ground between the posts for complementarity to slide into competition. In the model, both posts serve the board, and the chair, or CGO, is not the CEO's boss. The CEO has one master, the board, and one responsibility, managing the business in accordance with the policy framework set by the board. Equally, however, if the posts are to be held by the same person, then the clearer role definitions encapsulated in the new model should make it easier for that person to distinguish between them. Knowing which hat the CGO-CEO is wearing at any given time will also be of benefit to both board members and managers.

Clearly chairs, or CGOs, have a leading part to play in ensuring that governance boards work in the way the new model outlines. As Carver and Oliver say, "We believe that the chair's role is one of the most important keys to unlocking the potential of boards, and we are therefore going to give it considerable attention." I strongly support the importance that the model gives to the chair's role. This book stresses that the board must speak with one voice and that the CEO takes directions only from the board as a whole. The board will speak with one voice only as a result of directors' commitment to do so and the skill of the chair. I doubt that what is required of a person to serve well on any type of board or committee is a natural form of behavior. The key task of a chair is to enable the members of a board to work together effectively and to get the best out of them. This is what the servant achieved in the story on which Robert Greenleaf's concept of the *servant-leader* is based. Chairs have a major leadership task. It is they who are responsible for turning a collection of competent individuals into an effective team. The new model is demanding of its chairs, and much will depend on them.

Another field in which the new model scores high is that of appraisal. One of the more difficult tasks facing boards today is accurately appraising their own performance and that of the exec-

utives. A Policy Governance board has clear criteria against which to evaluate its own effectiveness. That is, it evaluates itself against its own terms of reference, having already debated what those terms shall be. Similarly, the CEO and the executive team are appraised in terms of the performance of the company. All appraisal is carried out against known and agreed criteria, with the aim of learning from the process.

One of the outcomes of the design of the new model is that it relates governance to ownership and to active ownership at that. Governance is a separate function in its own right and is not a higher level of management. Governance sets the framework within which whatever is being governed can be managed. Good governance does not involve emasculating management. Strong boards deserve strong executives, and strong executives should welcome working with boards that give them a clear remit and operating freedom within known limits.

The object of *Corporate Boards That Create Value* is to assist boards to make the significant advance of which they are capable in the interests of their owners and more broadly of society. My hope is that this book will be widely read, debated, and discussed by those charged with running organizations of all kinds. We should not shy away from examining the theoretical underpinning of the systems and processes whereby we direct and manage our institutions. As John Carver and Caroline Oliver explain, rational governance must be designed from a coherent paradigm. They have now offered us that paradigm.

Knowle, Solihull, West Midlands
May 2002

SIR ADRIAN CADBURY

Sir Adrian Cadbury has been chairman of the Committee on Financial Aspects of Corporate Governance in the United Kingdom (“The Cadbury Report”), a director of the Bank of England, chairman of Cadbury-Schweppes, and the Chancellor of Aston University. He is the author of *The Company Chairman* and an honorary fellow of King’s College, Cambridge.

To Miriam and Ian

Introduction

If we do not concern ourselves with how we can
rule organizations, the organizations will rule us.

—J. Keith Louden¹

Whether driven by increasing understanding that governance is not simply management writ large, by taunts of “where was the board?” or simply by directors wanting to do a better job, the scene in corporate boardrooms today is encouragingly different from what it was just a few years ago. We believe it can be even better.

This book is about the job of corporate governance. The word *governance* has several definitions, but in this book it means simply the role of the board of directors. As we proceed, we offer definitions of the nature and proper value of this role and then follow that discussion with implications for everyday corporate life. Consequently, this book is both conceptual and practical.

Calls for boards to exercise their authority over management are increasing. This book explains how boards can assume the full potential of that authority, gaining strength and autonomy without sacrificing management potency. The challenge for strong boards is not so much to tolerate strong management as to *demand* it. Greater board assertiveness, already a fast-developing reality, must be shaped so as to produce powerful management, not feeble management. A coherent and practical concept of governance is needed that drives the changing board-management partnership to function at its best.

What we wish to contribute is an operating system to meet this need—the Policy Governance model. We believe this model

offers the coherent and practical concepts required. As a framework, it provides a way for the board to look at corporate issues, separating its role from that of management, delegating powerfully, yet retaining its own accountability. We address, first, the governance mind-set, or—more accurately—the organizing principles of that mind-set, then a process that supports and guides it, and finally the practical documents that capture and codify it. So although we seek to affect the way directors *think*, we also demonstrate how new thinking can enable boards to *act* with a more precise balance of authority retained and authority delegated away.

The Readers of This Book

This book is written, first, for directors who despite recent advances continue to search for insights, new ideas, and even helpful theory. We do not mean to devalue the practical. Far from it. Our goal is to offer practical solutions built on an increasingly coherent framework for corporate governance as a function in its own right. To put a finer point on it, this book is written for those directors who search for a coherent, underlying framework for the board job—practical guidance, to be sure, but practice founded in a carefully constructed set of ideas about the nature of the board job itself.

We also write for people who consign their wealth to the care of corporate directors as well as for those who work for them and with them and those who regulate them. For all involved in governance, be they directors, investors, executives, consultants, academics, or regulators, we offer a way to view, support, and evaluate the stewardship of boards. We ask those of our readers who are not directors to understand that our intention in having the book speak directly to directors is to serve rather than exclude the interests of all readers.

Laying the Foundations

Before demonstrating the concrete application of the Policy Governance model, we ask the reader to consider a number of ideas—some familiar and some not, some easily accepted and some not.

These ideas create the foundation, the context, from which the practical application logically flows. Readers will have varied responses to these ideas, as people do with any new way to organize any work. Some directors will find nothing new here but a codification of their own beliefs. Some directors will find only ideas with which they are instantly comfortable. Others will find the ideas strange, at least initially.

Our goal has been to minimize barriers to understanding, but we cannot completely avoid one particular hurdle: specialized language. Much as we want to minimize jargon in a jargon-filled world, we find that new concepts and new ways to organize old wisdom often require new tags to distinguish them from old ideas or more familiar ways. New terms as well as common terms that we are using in particular ways are defined in the glossary in Appendix A.

Explaining how and why the Policy Governance model works appears to us to be a responsibility as large as the potential rewards it offers of corporate transparency, clarity, role definition, and accountability. We know from many years' experience in working with boards that the substantial changes this book proposes produce significant improvement in directors' perception of their effectiveness. We also know that highly effective governance is impossible unless the conceptual foundations are fully laid.

Governance, Not Management

Underlying this book is the assumption that governing a company and managing it are different activities requiring different job designs. We maintain that governance is best seen as existing *outside* the phenomenon of management and *inside* the phenomenon of ownership. Governance operates at a level that transcends current issues and specific company traditions and elevates people to a higher conceptual plane, one from which accountability can be seen more clearly. Governance requires and engenders a passion for leadership, leadership that is not just over others but on others' behalf.

This book is not about merely adding more “best practices.” Practices stem from individuals’ views of the world. Whatever your view of the board’s accountability, you might profitably spend time learning improved methods, protocols, and techniques to better fulfill that view of the job. But better practices rarely change the view itself, much as word processors did not evolve through efforts to improve typewriters. Recent years have seen an explosion of interest in best practices, and we hope that interest continues. But our contribution is to question and recommend change in the view of the job itself. To the extent we are successful, organizations should see a whole new round of best practices—ones built on this new paradigm.

We believe that despite all the increased attention to the topic of governance and the resulting improvements to board structures, processes, and practices, a fundamental deficiency remains. This book sets out to fill that gap by unifying governance concepts and practices in one logical operating system, Policy Governance.

What You Will Learn

As we set out the Policy Governance framework, you will be introduced to some perspectives on governance that will be of interest whether or not your board ultimately decides to use them. To give you a flavor of what is to come, we offer the following propositions:

- Significant advances in governance will occur only when people recognize that governance is not a subcategory or extension of management but a subcategory or extension of ownership. *The nature of board work, then, is not management one step up but ownership one step down.*
- A board must be an active, deciding, independent link in the chain of authority from owners to operators. *Accountable boards, then, are commanders, not advisers.*
- Assertive fulfillment of the board’s authority need not yield weak management. *Proper delegation, then, must result in board control and management empowerment simultaneously.*