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BOARDS

Boards Must Be More Combative

by Stuart Jackson

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Boards of directors play two roles. They must protect value by helping companies avoid unnecessary risks, and they must build value by ensuring that companies change quickly enough to address emerging competitive threats, evolving customer preferences, and disruptive technologies.

With technology and business model cycles becoming shorter and companies facing unrelenting pressure to innovate or suffer the consequences, more and more boards need to focus on the second of these roles. To do so, they must be willing to challenge executive teams and stress-test their strategies to ensure they go far enough and fast enough. For boards used to preserving the status quo, this shift can be uncomfortable. Here are four ways boards can become better challengers and champions of change.

Confront Unwelcome News and Trends

Changing strategy is extremely difficult, especially for successful businesses. In the early 1990s Blockbuster commissioned a study on the future of video-on-demand technologies and how they would impact traditional video rentals. The report concluded that expanded cable offerings and broadband internet would begin to impact video rentals around 2000, and would grow rapidly thereafter. The good news was that Blockbuster had a good 10 years to prepare for the new environment. But the shift never happened: Management ignored the study's findings and continued with the same strategy, supported by the board. In September 2010 Blockbuster filed for bankruptcy protection. In this case, value protection was not enough. The company had clear advance notice that seismic change was coming.

The board's role was to acknowledge the warning signs and challenge management's lack of action — even if it meant contention and dispute in the boardroom.

Make Sure You Have Challengers in Your Midst

Boards will be far more effective in their challenger role if they offer seats to individuals with professional experiences and viewpoints that are very different from those of the executive team. Directors can learn to be more direct with management, but it's hard to fake contrarianism when everyone is of the same mind. When a board resembles the CEO in mindset and outlook, it's a recipe for a gatekeeper board, not a challenger board. But when boards mix it up by bringing in members with different perspectives, they can effect powerful strategic changes, something I have seen many times in my work with corporate boards.

Often, these "challengers" will be tech-savvy young executives from digitally disruptive companies who can press their fellow directors and senior management about potential blind spots related to digital disruption. But disruption is not always about technology. For example, one highly successful, privately-held producer of canned foods actively sought a board member who could challenge management to think differently but who would still fit with the company's family-oriented governance culture. The successful candidate was the CEO of a well-known, family-owned California wine business that catered to consumers who would not dream of buying canned food. The board member helped the company "think outside the can" to identify new product forms that would broaden their customer base and appeal to health-conscious consumers.

In another instance, a leading chain of retail pharmacies appointed as vice chair someone with a background in health care manufacturing and pharmacy benefit management. The new board member helped management better understand the efficiency advantages of mail-order pharmacies, which rely on automation. As a result, the company added low-cost automated pharmacy services to its existing retail outlets, giving it a competitive advantage over traditional retail pharmacies.

Stay Fresh with Term Limits and Checks and Balances

Beyond accessing the right expertise, boards can maintain a challenger perspective by ensuring they don't become complacent and drift toward an approver role. One of the most effective ways to do this is to establish mandatory term limits as a part of the board's bylaws. Term limits can help boards maintain a level of independence between the outside directors and executive leadership.

Moreover, if the CEO and chair roles are separated, the chair can take more active responsibility for ensuring that alternative views and perspectives are brought before the board. Separating the roles is a common practice in Europe, and it's becoming more so in the United States. Another option is to appoint an independent lead director, a less drastic change that can have a similar effect. In fact, the New York Stock Exchange essentially requires listed companies with nonindependent chairs to appoint one of their independent directors as lead director. The lead position, among other duties, is responsible for scheduling and helming board meetings that take place without management. Today the majority of S&P companies with combined CEO and chair roles have chosen to counterbalance this arrangement by appointing an independent lead director.

Turn Courage and Candor into Core Competencies

Having directors with valuable insights is worthless if they do not feel comfortable sharing their perspectives and debating issues with management. A recent study by Women Corporate Directors and Bright Enterprises found that more than three-quarters (77%) of director respondents believed that their boards would make better decisions if they were more open to debate, and 94% said that criticism can help bring about change when it is used properly.

Nevertheless, board members are often hesitant to offer criticism, especially to CEOs. The same survey found that only about half (53%) of respondents felt that the CEOs of their companies take criticism well. This is not surprising. As a board member it is much easier to empathize with a CEO under pressure than with an abstract group of shareholders. One way to address this issue is to offer board members training in giving and receiving constructive criticism. Board members need to understand that failing to confront difficult issues will not help the CEO. If a CEO's first indication that the board is dissatisfied is hearing they are searching for his or her replacement, then the board is not fulfilling its responsibilities.

Challenger boards are those with the strength to put the hard questions to management and to poke holes in suboptimal strategies. They bring a diversity of perspective that can help management understand the company's vulnerabilities and how to overcome them. For companies struggling to exist in a world where disruption is rapidly becoming a business constant, challenger boards may well be one of their most important survival tools.

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