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Communication Between the Board and the CEO

By Ralph Kikkert, 2005

One foggy night, the captain of a large ship saw what appeared to be another ship's lights approaching in the distance. The two were on a course that would lead to a certain head-on collision at sea. Quickly the captain signalled, "Please change your course ten degrees west."

The reply came blinking back through the thickening fog: "You change your course ten degrees east." The captain, now insulted, decided to pull rank, as he angrily sent a message back. "I am a sea captain with 35 years of experience. Change your course ten degrees west!" Without hesitation, the signal flashed back, "I'm a seaman, fourth class. You change your course ten degrees east!"

The captain became enraged. Realizing that they were rapidly approaching one another and would most certainly collide in a few minutes, he sent his final warning. "I am a 50,000-ton freighter. Change your course ten degrees west now!" A simple message came blinking back that foggy night: "I am a lighthouse. You choose."

We expect the captain would have changed his course and ate his words as he flirted with disaster. So with us—our paradigms and experiences can create fog in our organizations and make it more difficult to communicate effectively. Some boards create their own foggy structures or processes that reduce communication effectiveness.

> *Words to the Wise*
> Solid organizational structure enables effective communication.

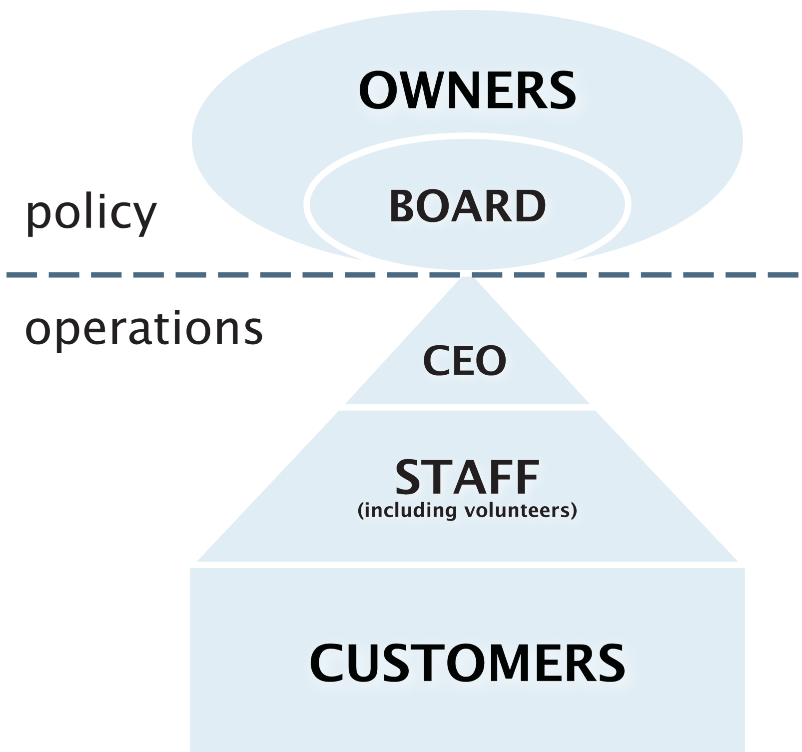
In this article we will review the communication process between the Board and the CEO within different governance structures. Despite their best intentions, boards of organizations can easily fail to communicate effectively. Therefore we need the best possible organizational structure to reduce the risk of communicating in the fog and experiencing disastrous results.

The quality of communication between the board and the senior staff person greatly impacts an organization's success. In today's society there is considerable variation in the ways these organizational leaders communicate with each other. Even if an

organization is currently performing well, poor internal communication at any time can place the organization at risk.
Many organizations exercise less-than-ideal communication between the board and CEO. This may be because they are not aware of more effective structures. They often try to make improvements to their ineffective processes but problems will still exist when the basic structure is flawed.

Let's review some structures common today, and consider their strengths and weaknesses regarding internal communication.

The Secret Formula



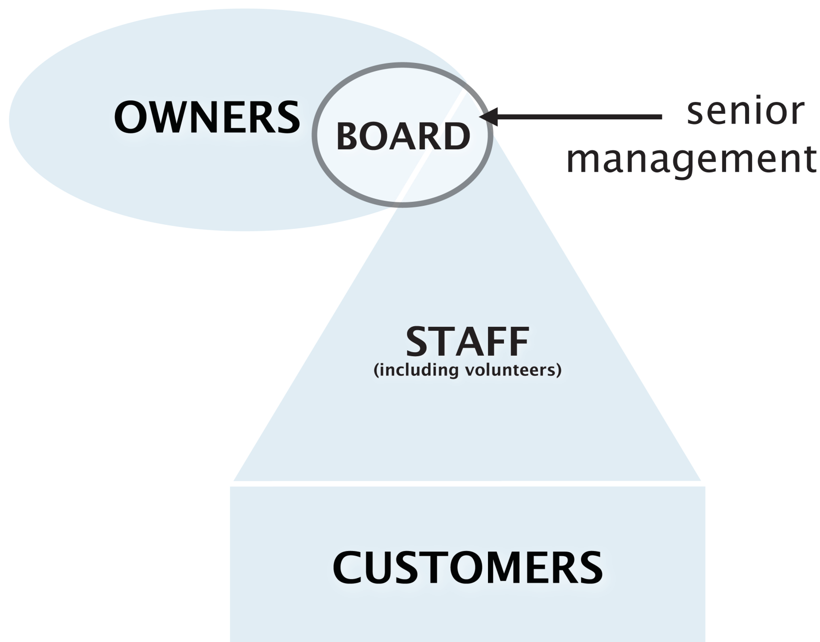
The Secret Formula for Effective Organizations™ supports the principle that all communication between the board and the staff flows directly through the CEO. Policies agreed upon by the board are written down to provide clear direction to the CEO and the rest of the organization.

One sound governance principle is that the CEO provides essential input to the board but has no vote. The CEO sits in on all board discussion (except discussion about her own performance) so she can provide input that enhances decision-making and so she thoroughly understands the thinking behind the board's decisions. Another principle is that the board is made up of external members of the organization, rather than management or staff members. Since the debacles of Enron and WorldCom, securities regulators encourage the majority of board members to be external. A third governance principle is that the board elects a chair to facilitate the board governance processes. Senior level communication is directly between the board as a whole and the CEO, to ensure the CEO is clear on the board's direction and enabled to implement it throughout the organization.

Together, the board—which brings an objective perspective on behalf of the owners—and staff—with the knowledge and practicality of implementing the direction—make a strong team. Once the direction is set through a strategic plan, the board can protect the owners' interests by holding the CEO accountable to the set direction.

The Secret Formula model is simple but very effective. The board only deals with policy issues including articulating the big-picture outcomes it expects the organization to achieve while the staff addresses operations. Board and staff each have specific areas of responsibility; their roles are clear. Communication is consistent and clear because the written governing policies declare the board's direction.

The Soon-to-Be "Old Corporate Model"



Many public companies follow a tradition that assigns the senior person in the organization the title of Chair and CEO. In such cases it is common for senior management staff to also be board members. Although this design has been strongly criticized because of the inherent conflicts between the management team's board and senior staff roles, it is still quite popular. If you have a great CEO, this structure allows for easy and quick implementation of strategies to assist the organization in meeting its goals. If he is competent and has outstanding integrity, he may make positive things happen in the organization. Problems will still exist, though. A common concern is that the board is not independent of management and, therefore, will not challenge inappropriate management decisions. Boards with this makeup are in conflict when setting the CEO's compensation package or considering a potential merger or takeover, particularly when the agreement incorporates signing bonuses or large severances for executives. An illustration of this is the $187.5 million compensation package for Richard Grasso, the former Chair and CEO of NYSE. The risk of abuse of power by the organization's leaders is greater with this structure.

To enable this structure to work somewhat reasonably, other forms of accountability must be exercised to guard against abuse. An example is the Sarbanes-Oxley Act which imposes a lot of extra paper work. Even if all these regulatory guidelines are followed and there are performance problems, it is still difficult to remove the CEO for inadequate results. In addition, when there are so many staff members on the board, there is little outside board objectivity to support, challenge, and re-direct management.

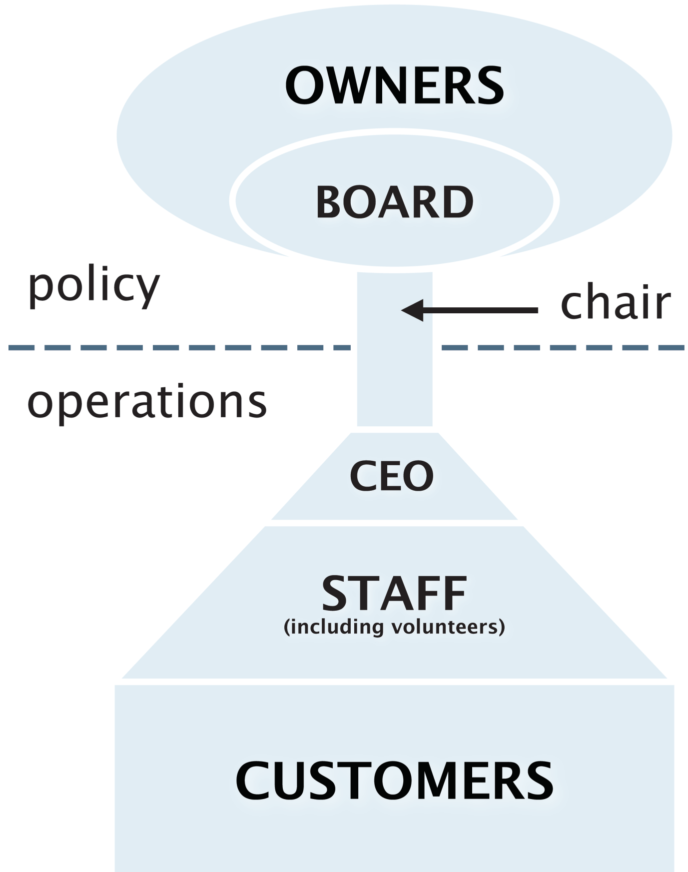
When using this structure, much of the discussion at board meetings can be operational in nature as many attendees also wear a senior management hat. Typically the staff set the direction for the organization and present it to the board for reaction. In such situations, the board, although legally liable and responsible for the direction of the organization, often acts as an advisory group. Outside directors (directors who are not also staff of the organization) seem to lack the needed clout to create necessary change. The Chair/CEO position has too much power with little accountability – the same person has control over both board and staff members and generally isn't held accountable by anyone. Board members are often influenced more by what the Chair/CEO wishes than what is ethically appropriate and in the best interests of the shareholders.

Many organizations still follow this traditional board governance structure. It seemed to work fairly effectively in the past when directors and CEOs had high integrity and the CEOs worked exceptionally hard to meet the shareholders' expectations.

Today the approach is faltering. It exposes organizations to unacceptable levels of risk. Shareholders, accounting firms, and stock exchanges are putting bandages on this design by requiring more of external audit firms. Companies are required to follow more stringent practices. The audit committee's role is increasing. These recent changes, however, have not addressed the basic board conflict of the CEO being board chair and senior management being board members.

The Chair Supervises the CEO

In some organizations there is no formal communication directly between the board and senior management. All information flows through the board Chair who communicates expectations to the CEO and evaluates the CEO's performance. The board makes broad decisions at board meetings and the Chair then communicates the decision with details that reflect the board perspective, or that unintentionally or intentionally reflect his personal preferences. The Chair typically has more power than other board members and fulfills part of what should be the CEO’s role. He often involves board executive members in some of the discussions so that he has more support at the boardroom table. The irony is that the CEO is accountable for results in this model, but the Chair is not. In practice, the Chair has operational authority within the organization but will not be held accountable until he is considered for another term as board Chair.

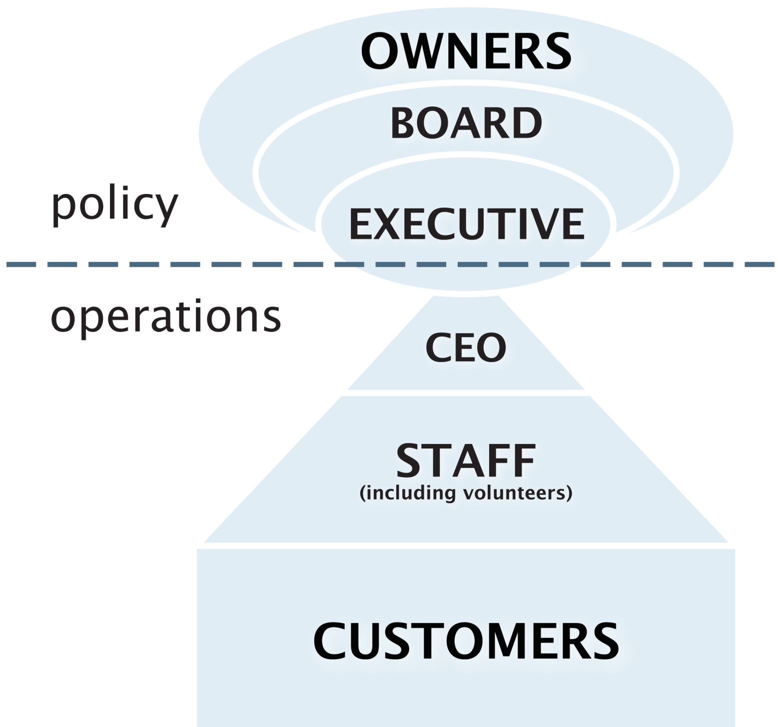


A common challenge in this approach is that there is no direct link between the board as a whole, which is responsible to members or shareholders, and the CEO, who is responsible for implementation. Secondly, it is very difficult to hold the CEO accountable to the whole board for the organization’s results since expectations were not communicated by the board as a whole. In addition, the Chair may abuse his position in various ways. He could act as the CEO, actively managing operations, or get in the way of the CEO, and yet leave the CEO to take the blame if things do not go well. In some instances, a Chair may even believe that as a trustee for the owners or membership, he has to be present in the office frequently to sign cheques or monitor the CEO’s day-to-day decisions.

Competent CEOs are not satisfied to be at the Chair’s beck and call. They often quit when the Chair moves into operations, leaving the organization with more challenges. If the board Chair sets operational direction, the organization probably lacks consistent long-term direction. Whenever a new Chair is elected, the organization’s focus may change. Valuable time is lost as the new Chair and the CEO get up to speed with their respective roles and the revised organizational priorities.
With this structure, board members feel powerless as the Chair often sets the direction and calls the shots. The other board members are treated as second-class citizens receiving limited information about the organization.

Many leaders in these organizations are not willing to consider a different structure as their power and control would be reduced. However, more and more board members are not willing to put up with this structure, as they are becoming aware that they are legally responsible for the decisions the Chair makes on their behalf. This is another flawed structure that creates undue risk for the organization and liability exposure for the board members.

The Executive Board



There are large boards which find that their group size leads to ineffective and inefficient decision-making. They therefore create an executive of, say, 7 board members who meet as often as, if not more frequently than, the board to make decisions for the board. This executive committee ends up directing the CEO and the organization.

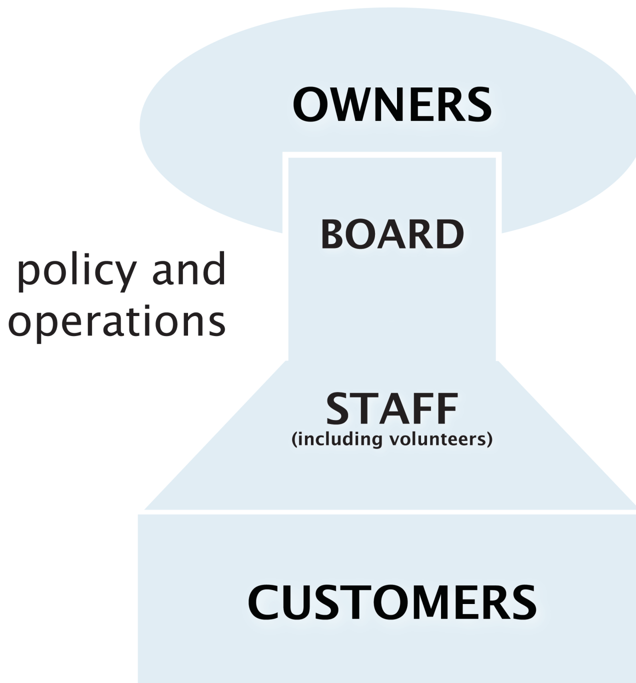
The full board does not communicate directly with the CEO but rather only hears reports about progress and gives suggestions for the executive committee to consider. The full board does not have an effective role in directing and monitoring the organization's activities. This model prevails because of the belief that all segments of the membership must have a representative on the board. It also persists because of misguided notions that blind trust between the board and the executive committee is legitimate, and because of the limited understanding of the legal responsibilities all board members have for the decisions the executive committee makes on their behalf.

These boards are too large to truly allow the diverse membership to be represented. Since the smaller executive committee typically makes the majority of the decisions, there is no more diverse input into decision-making than if the board had fewer members. In an attempt to represent the membership, the full board tends to function as an advisory group. Yet all board members have legal responsibility for all the decisions made by the executive committee.

We agree that the election or appointment of a large group to represent the organization's constituents has merit. We suggest that they form an advisory council. Then the small group that used to be the Executive Board can be the full legal board. The advisory council can meet one to two times per year to advise the board on behalf of the membership. And the right-sized board can fulfill its responsibilities effectively, efficiently and likely at a much lower cost to the owners.

The Working Board

Working boards are common for small organizations where the board gets together often with staff to make all decisions for the organization. The board meetings are long and deal with the many issues the organization faces.



The board members may also be very active as volunteer staff. The board is typically so busy with day-to-day operations that it never gets to planning or setting policies for the organization. The people on the board often enjoy this role as their extensive involvement makes them feel helpful and making decisions gives them a feeling of importance. This model may work well for small start-up organizations when enthusiasm is high and there is little money to pay staff. However, the model quickly becomes ineffective when the board has full-time staff or highly involved board members get burned out and resign, leaving holes that others are reluctant to fill.

In many working boards, no one takes responsibility for planning the future, no one takes responsibility for assessing the organization's performance, and no one holds the organization accountable to its owners' or membership's desires. The risk here is that, with the preoccupation of operations, a "freight train" may hit the organization because no one was looking out for the future or the changing business environment.

Other challenges of working boards are that staff and board become confused about their roles. Individual board members may direct staff while the senior staff person is responsible for their results. Conflict often arises between staff and board with staff being unclear on who they report to for what. When talented staff members cannot exercise their abilities, they can become demoralized, and may look elsewhere to use their skills.

Some senior staff enjoy the working board model because they are 'doers' rather than strong leaders. They are happy to do what they have been asked to do rather than make leadership decisions. The board in this model acts as the CEO, fulfilling the duties and responsibilities of the CEO, and the senior staff person acts as a manager reporting to the CEO.

This structure, too, is flawed as planning for the future of the organization is poorly done, board members become burned out with all the meetings and time demands, and great staff often leave due to conflict and lack of challenge.

Summary

For effective communication between the board and the CEO, there is only one effective model—The Secret Formula for Organizational Effectiveness™. We encourage you and your organization to become familiar with and follow this model. It will enable you to build on the strengths and talents of the board members and staff, reduce the board members' liability, create an even stronger organization that achieves greater results, and enjoy the resulting harmony.