The Modern Day Board

"Professional, Results Orientated, Data Analytical, Decision Body with Respect, Trust and Candor"

Dear Clients, Friends and Colleagues,

I have decided to write this paper **The Modern Day Board: "Professional, Results Orientated, Data Analytical, Decision Body with Respect, Trust and Candor"** because during my 20 plus years of working with Boards I have come to appreciate how critical their role is in leading a company to success. But not all Boards see their role as such.

My experience of working with high performing Boards, particularly of private equity portfolio companies, has made me appreciate the importance of speed; effectiveness of analyzing data and decision making; and clear communication, both in terms of managing Board activity as well as facilitating the translation of the Board's strategy into successful managerial actions. I believe the Modern Day Way, as described in the attached white paper, of operating Boards has a lot to offer to many, if not all, companies. **Boards need to lead from the front.**

This very competitive global market requires a transformation in the role the Boards play within their companies, and I believe that my international experience can help facilitate this transformation in a way that brings the best international practices and, at the same time, customizes them to the specific needs of the individual companies.

The attached white paper that I authored distils some of the lessons and strategies that can help develop exemplary and value-adding Boards to lead high performing companies.

Over time, good-governance advocates have developed no shortage of remedies for failures of governance at businesses. **However, good and bad companies alike have already adopted most of those corporate practices but improvements are still needed at many Boards to improve shareholder value.**

There are subtle differences between traditional public Boards, Boards of private equity portfolio companies and other privately owned company Boards. The more "engaged form of corporate governance" and active ownership exhibited, typically but not always, by private equity Boards does provide us with some ideas as to how more traditional public and private company Boards could be more effective at delivering shareholder value. It is the combination of the clarity of purpose and the shorter lines of communication that enables private equity Boards to act quickly and without having to worry about next quarter's earnings announcement (except for potential banking covenant issues). Moreover, being proprietors they are able to back their own judgment and move decisively. This is not the whole answer but **Chairmen might be well advised to promote a more focused, results-oriented and decisive Board culture; one which is engaged but not too close to the management (executive) team; and which allows for contentious and dissenting discussions.**

A major responsibility of the Board is to ensure the viability and sustainability of a well-run business, as in accordance with the wishes of the shareholders. Boards must not be complacent and ensure that they continually receive relevant, accurate, timely and well-presented (actual and forecast) information from management so that the Boards can (i) have professional, results orientated, data analytical discussions with respect, trust and candor; (ii) apply their "judgement" to taking proactive and decisive decisions; and then (iii) clearly communicate their decisions to management so that there are no doubts in anyone's mind what has been agreed and why.

Thinking beyond the status quo will be crucial for Boards to help their companies stay agile and competitive as they maneuver the rapidly changing business landscape, in terms of technology and economic and market conditions. **It is also as important as ever for Audit committees**, which continue to wrestle with heavy task loads, **to stay focused on their core oversight responsibility—financial and operational reporting integrity so that good decisions can be based on good data.**

The most involved, diligent, value-adding Boards may or may not follow every recommendation in the good-governance handbook. **But if a Board is to truly fulfill its mission as (i) Advisor; and (ii) Oversight, the Board must both (i) receive timely, accurate and relevant information; and (ii) get The Human Element right which allows for a Professional, Results Orientated, Data Analytical, Decision Body to act with Respect, Trust and Candor.**

If I can help you, your colleagues or clients with selective Board roles or with advising Boards on various business issues with a particular focus on M&A, financial and operational reporting and monitoring, corporate governance, international expansions or non-performance issues, please let me know. We are here to help deliver shareholder value.

Best regards

David

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Executive Summary

Over time, good-governance advocates have developed no shortage of remedies for failures of governance at businesses. Most of these remedies are structural (e.g., rules, procedures, composition of boards of directors ("Boards") or committees), and together they are supposed to produce vigilant, involved Boards. **However, good and bad companies alike have already adopted most of those practices but improvements are still needed at many Boards to improve shareholder value.**

There are subtle differences between traditional public Boards, Boards of private equity portfolio companies and other privately owned company Boards. The more "engaged form of corporate governance" and active ownership exhibited, typically but not always, by private equity Boards does provide us with some ideas as to how more traditional (public and private) company Boards could be more effective at delivering shareholder value. It is the combination of the clarity of purpose and the shorter lines of communication that enables private equity Boards to act quickly and without having to worry about next quarter's earnings announcement (except for potential banking covenant issues). Moreover, being proprietors they are able to back their own judgment and move decisively. This is not the whole answer but **Chairmen of public companies might be well advised to promote a more focused, results-oriented and decisive Board culture; one which is engaged but not too close to the management (executive) team; and which allows for contentious and dissenting discussions.**

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The most involved, diligent, value-adding Boards may or may not follow every recommendation in the good-governance handbook. **But if a Board is to truly fulfill its mission as (i) Advisor; and (ii) Oversight, the Board must both (i) receive timely, accurate and relevant information; and (ii) get The Human Element right which allows for a Professional, Results Orientated, Data Analytical, Decision Body to act with Respect, Trust and Candor.** This white paper takes a look at some of the common issues and strategies to help develop exemplary and value-adding Boards of above performing companies.

Increasing Expectations of the Chairman of the Board – The Tone First Needs to Be Set at the Top

The Chairman of the Board ("Chairman"), together with Company Secretary, is primarily responsible for the effectiveness of the Board. This means setting the right (i) "Human Element"; and (ii) Structure of the Board, be it agendas, schedules, distribution of information and coordination of actions delegated to sub-committees. In many companies, CEOs serve as Chairmen; in other companies the role is separated. In turn, the Chairmen of the sub-committees are responsible for the effectiveness of their committees.

A good Board should exhibit the following four key characteristics:

1) **Focus** – clear agreement with management about what is important;
2) **Decisiveness** – a preparedness to act;
3) **Results orientation** – a restless search for super-returns; and
4) **Engagement -** robust and regular communication within the Board and with management.

The above will not be achieved by purely following every recommendation in the good-governance handbook. **What distinguishes exemplary and value-adding Boards is that they (i) receive timely, accurate and relevant information; and (ii) get The Human Element right which allows for a Professional, Results Orientated, Data Analytical, Decision Body to act with Respect, Trust and Candor.**

Human Element of the Board

- **Respect, Trust, Dissent and Candor**

  Well-functioning, successful teams usually have chemistry that cannot be quantified and which one good quality builds on another. Team members develop mutual respect, they share difficult information; because they all have the same, reasonably complete information, they can challenge one another's conclusions coherently. If a Board is healthy, the CEO provides sufficient information on time and trusts the Board not to meddle in day-to-day operations. The CEO provides Board members free access to people who can answer their questions, obviating the need for back channels.

  However, integrity can be broken at any point. One of the most common breaks occurs when the CEO does not trust the Board enough to share (bad) information or corrects information which was wrong on a timely basis. What kind of CEO waits until the night before the Board meeting to tell them the company has missed earnings for the second consecutive quarter? Surely not a CEO who trusts the Board. Another common break in integrity is when the Board talks with other members of management without telling the CEO.

  Boards must not be complacent and ensure they continually receive relevant, accurate and timely information so that they can apply their "judgement" to taking proactive and decisive actions. Perhaps the most important task of the Board is to challenge one another's assumptions and beliefs. Respect and Trust do not imply absence of disagreement but represent bonds which are strong enough to withstand clashing viewpoints and challenging questions. Leaders must believe in the distinction between dissent and disloyalty. The highest-performing companies have extremely contentious Boards that regard dissent as an obligation and that treat no subject as undiscussable. Executive sessions are rarely held as what is the point of asking management to leave while they discuss the company's performance. What is the point of criticizing management if management is not there to answer the criticism? Accordingly, there must be significant level of engagement with the management.

Private equity Directors do not tend to respect the normal hierarchy of communication. They assume the right to visit operations, talk to staff and meet customers, often at will. In this way they develop a degree of familiarity and engagement with the business which enables an authoritative engagement with management. Management on private equity Boards comment on the relative lack of the formality; the robust nature of debate and the high level of contestability on key points. They also report that by the end of the meeting there is no doubt in anyone's mind what has been agreed and why.

- **Individual Accountability and Feedback**

  We have seen many times when individual responsibility dissolves to a larger group or when one person does all the talking and never listens or considers other people's views; neither approach is good. That is why is it is so important that individual Directors' and the combined Board's performances should be assessed very rigorously on a regular basis. No matter how good a Board is, it is bound to get better if it is reviewed intelligently and is engaged.

  Most often, the nominating or governance committee drives these evaluations. A full Board review can include an evaluation of such dimensions as its understanding and development of strategy, its composition, its access to information, and its levels of candor and energy. In individual self-assessments, Directors can review the use of their time, the appropriate use of their skills, their knowledge of the company and its industry, their awareness of key personnel, and their general level of preparation.

  This approach can also be used to identify what the Board should be concentrating on for the next year. However, the Board should not wait for the annual review to be performed but should suggest improvements to the Board's role immediately as the independent directors' time is limited; also a badly run Board can soon lead to disengaged Directors.

  The level of familiarity and engagement between management and Directors of private equity companies enables the Directors to provide management with timely observations; immediate feedback and, where appropriate, coaching, often drawing on their experiences from other sectors or business. In the private equity environment, there is typically a close and productive working relationship between the Chairman and CEO. When there is an issue, it is dealt with quickly and openly. Sometimes this means CEOs of private equity companies do depart prematurely but rarely does the relationship deteriorate into dysfunctionality or resentment. Private equity also needs to be careful that they do not get too close to management so that management does not become too dependent on the private equity firm.

The Structure of the Board

- **Combining versus Splitting the Roles of Chairman and Chief Executive Officer**

  The CEO is the company's top decision maker - all other executives answer to him or her. The CEO is accountable to the Board for the company's performance. The Chairman of the Board is the head of the Board. The Board is typically elected by shareholders and is responsible for protecting investors' interests, such as the company's profitability and stability. The Board selects the Chairman.

  In many U.S. companies, the CEO typically also serves as Chairman of the Board. In the U.K., best practice for public companies is for the roles of Chairman and CEO to be split and for the Chairman to be independent and not be an ex-CEO or executive director. The issue of whether holding both roles reduces the effectiveness of the Board is a hot topic. There are good reasons to separate the two positions in both private and publicly listed companies in order to strengthen the overall integrity of the company.

  One of the Board's main roles is to monitor the operations of the company and to ensure that it is being run in conjunction with the mandate of the company and the will of the shareholders. As the CEO is the management position responsible for driving those operations, having a combined role results in monitoring oneself. A Board led by an independent and engaged chair is more likely to identify and monitor areas of the company that are drifting from its mandate and to put into place corrective measures to get it back on track.

  Some argue that it costs more to have two roles in public listed companies. However, in 2012 GovernanceMetrics International performed a survey on 180 large publicly listed North American corporations and found that splitting the roles cost less in terms of remuneration that having a joint role.

- **Board Committees**

  There are four primary Board committees: (i) Executive; (ii) Audit/Finance; (iii) Compensation; and (iv) Nominating or Corporate Governance, although there may be others (e.g., Strategic Planning, Investment, Risk, Environmental Policy, Legal, Ethics/Compliance, Mergers & Acquisitions, Human

Resources/Management Development), depending on corporate philosophy and special circumstances relating to the company's line of business or stage of development.

It is usually recommended that the Compensation and Audit committees be comprised of Independent Directors. The Executive committee is a smaller group that might meet when the full Board is not available.

- **Board Member Skills**

  There are no rules about Board composition but it is well recognized that diversity (in terms of both skills and background) on Boards contributes to better decision making. Effective Boards also require their Directors to play a variety of roles, in some cases dipping deep into the details of a particular business, in others playing the devil's advocate, or others helping to set the long-term strategy. Playing different roles gives Directors a wider view of the business and of the alternatives available to it.

  Individuals who are asked to serve on a Board typically have several years of executive experience or other equivalent professional experience in key areas that are beneficial to the company. Board members should be representative of the constituents that a company serves, including ethnic diversity, gender, and age. It is certainly true that many Directors have had their jobs because they are friends of the CEO, famous, rich and well connected; but a good Chairman, together with the CEO, will perform an assessment of the needs of the company and the responsibilities of the Board and recruit the right number of people with the relevant skills, experience and background to support the company.

  Whether you are looking for Directors with Finance, M&A, international, production, marketing, strategy, HR, Executive, fundraising or sector experience, Directors should process key characteristics like professionalism, integrity, transparency, respect, intellectual curiosity, passion and with a high tempo with a will to win.

- **Timing and Agenda of Board and Committee Meetings**

  The agenda and timing of Board meetings and committees and information flow should be dependent on the requirements of the role and the status (e.g., in a stressed period or growth period) and complexity of the company. The Chairman must ensure that the Board meetings are efficiently run with well-prepared agendas so that the company makes good use of the limited Directors' time.

  It is impossible for a Board to monitor performance and oversee a business if complete, accurate and timely information is not made available **("You cannot improve what you do not monitor").** It is the responsibility of the Board to insist that it receives adequate information. The degree to which this does not happen is astonishing. I highly recommend that the information to be provided and how it is presented is clearly established in advance by the Chairman, with the assistance of the Company Secretary, so that the Board can review the right level and quality of information efficiently, as their time is limited, to enable them to know what questions to ask and so they can apply their professional judgement promptly and decisively. The information to be provided must not be too prescriptive; a good and confident CEOs will have the confidence to present additional information, be it good or bad actual or forecast news, when necessary. From my experience, the CEO's report should be the most important agenda item of the Board; if not, then there is something wrong with the CEO or with the analysis that is being presented to the Board.

While certain items (e.g., review of performance against budget, key performance indicators, CEO report) will always need to be discussed at every Board, I also believe it is a good idea to have certain agenda times set for specific Board and committee meetings so that key issues can be delved into (e.g., assessment of the company, organization, infrastructure and service/product offerings to see where the strengths and core (profitable) activities of the company are, budget and/or strategy review, audit and internal controls, financing arrangements, assessment of the Board and key executive staff, succession planning, risk management, customer and other external relationships, and HR assessment).

Regular meeting attendance by well-prepared directors is Rule 101 for Board meetings. Accordingly, Directors must receive well-presented information before Board meetings so that they can adequately prepare and so that the Board meetings can be used as discussion and action forum rather than a mere presentation forum. The Chairman must set the tone so that Board members are fully aware of their minimum expected performance.

- **Duties of the Board and Independence**

  The duties of the Board are embodied by the principle of fiduciary duty. The "duty of care" and "duty of loyalty" requires that Directors to make decisions with due deliberation and act "in the interest of the corporation" which is interpreted as "in the interest of shareholders" (or perhaps the creditors when the company is in the Zone of Insolvency). The "duty of candor" requires that the Board to inform shareholders of all information that is important to their evaluation of the company.

  An independent director, or outside director, is a member of a Board who does not work for the company. Independent directors are important because they bring diverse backgrounds to decision making and are unbiased regarding company decisions. Inside directors are members of the corporation, usually part of the corporation's management (executive) team.

  Good-governance advocates have argued that Boards with too many insiders are less accountable. However, typically half of Microsoft's Board are insiders. Previously, three of Warren Buffett's seven

Berkshire Hathaway Board members have the Buffett name, and another is his long-term vice chairman. Having very candid and well informed insiders can improve the knowledge of the independent Board members.

- **Board Member Age and Term of Board and Roles**

  According to one governance expert, "Enron melted down because it lacks independent directors and several are quite long in the tooth." However, age is often an asset. Accordingly, some Boards have term limits and age limits and others do not.

  However, I believe a term (e.g., two or three three-year terms) limit for Independent Directors is a good idea as it is often difficult for companies to suggest to Board members that they retire or leave. In addition, a non-performing Director should be asked to leave before his term is up. It is also a good idea to reallocate roles (e.g., Chairman of the Audit or Governance Committees) of Directors, say every two years, so that it brings in fresh ideas and impetus and in-turn leads to a more engaged Board.

  A Chairman of a Board recently said that you should always recruit better Directors than what you had previously and never be afraid to appoint better qualified persons than one-self as this will help with the sustainability of the Company and the Board and make succession planning easier (which is another important role of the Chairman and Governance Committee). As I said previously, better quality builds on another.

- **Board Size and Committees**

  Boards typically have between 7 and 15 members, although some Boards have over 30 members. According to a Corporate Library study the average Board size is 9.2 members. Some analysts think Boards should have at least seven members to satisfy the Board roles and committees.

  Some good-governance advocates propose small Boards to be good and large Boards to be bad. But big Boards have existed at some great companies (e.g., GE, Wal-Mart, and Schwab) along with some poorly performing companies (e.g., US Airways and AT&T). At the same time, small Boards were part of the landscape at good companies like Berkshire Hathaway and Microsoft.

- **Equity Involvement**

  Board members are assumed to be more vigilant if they have significant equity in the Company but this is not always the case. For example, Enron Board members owned significant equity in the company, and some were still buying as the shares collapsed.

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Call to Action

Thinking beyond the status quo will be crucial for Boards to help their companies stay agile and competitive as they maneuver the rapidly changing business landscape. It is also as important as ever for Audit committees, which continue to wrestle with heavy work load, to stay focused on their core oversight responsibility—financial and operational reporting integrity.

The most involved, diligent, value-adding Boards may or may not follow every recommendation in the good-governance handbook. **But if a Board is to truly fulfill its mission as (i) Advisor** (e.g., advising the CEO and other key executives; introductions and providing strategic advice); and **(ii) Oversight** (e.g., monitoring performance of the company, the CEO and other key executives; maintaining good corporate governance, risk management and regulatory compliance; setting of executive remuneration; and protecting shareholder interests)**, the Board must both (i) receive timely, accurate and relevant information; and (ii) get The Human Element right which allows for a Professional, Results Orientated, Data Analytical Body to act with Respect, Trust and Candor.**

Authored by: **April 15, 2016**

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Farrell Advisory Inc. provides highly customized corporate finance advisory services to Boards of mainly private equity firms, corporations and banks with regards to promptly and efficiently helping companies deliver shareholder value (i) through M&A/refinancing transactions; and (ii) who are not operating optimally via the Office of the Chief Financial Officer and Restructuring & Business Reengineering solutions offerings.

David Farrell has over twenty years of experience in Reengineering/Restructuring and Corporate Finance (buy-side and sell-side due diligence, carve-outs) either as a consultant (Partner and Managing Director) at Big 4 (KPMG), international consulting practices (FTI Consulting) and national accounting firms (Cherry Bekaert, a Baker Tilly network firm) or as principal (CFO or Strategic roles) at European listed businesses, covering both the strategic as well as the transactional side of the business, with deep knowledge of the U.S., European and emerging markets. Mr. Farrell earned a B.Sc. in Economics and Accountancy from Loughborough University in the United Kingdom. He is a Chartered Accountant ("ACA") in England and Wales, and has obtained the Corporate Finance ("CF") qualification from the Institute of Chartered Accountants in England and Wales ("ICAEW"). Mr. Farrell is presently on the Board of Higher Achievement, National Capital Poison Center and Capital for Children and has advised multiple Boards of public and privately owned companies on various M&A, restructuring and business issues.