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The online newsletter for better boards and better directors *Ralph Ward, Publisher/Editor*

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WHEN "GOOD BOARDROOM CHEMISTRY" GOES BAD

In past issues, I've commented on the shift in board chemistry that hits when one or more members of the board come in as "outsiders." This can be through a merger or acquisition, through someone dropped into the boardroom via a new round of financing, or to assuage an unhappy investor.

Cases of the latter are making the news currently. Darden Restaurants in the US, under investor pressure, sacked its CEO, Clarence Otis. CEO ousters are nothing new, but the Darden board also reached a deal with activist fund Starboard Value allowing the fund to name 3 candidates to Darden's 12-member board slate, retaining just 9 of the current board.

Also, as noted below, US Auto Parts made a deal with investor Timothy Maguire that one member of the board would be someone both parties can agree to (and if there is no agreement, Maguire gets and keeps the seat). American Apparel, Tessera Technologies, Microsoft, and Mondelez are just a few of the other boards that have made room for new members lately in shotgun weddings.

Of course, the boardroom boy's club is already under siege through increased calls (and, in much of Europe, legal demands) for greater diversity, particularly based on gender. EU countries have enacted a range of prods, from "comply or explain" standards to outright gender quotas to boost the number of women on corporate boards.

While none of these are new phenomena, the increasing pace of boardroom interlopers means that we'll have to re-examine past rules of "good boardroom chemistry." We've been long assured by directors, CEOs, consultants, and others in the know that good chemistry among a friendly team of like-minded board members is vital to effective governance. But that "team" is getting a bit fractious. The board as a self-perpetuating group of cronies now sounds bad, looks bad, and increasingly doesn't reflect boardroom reality. Yet most of our standards of how the board should function are still based on this outdated model.

What we need are new tools and examples of how these "blended" boardrooms can work in the real world. A board that includes genders, races and career paths outside your circle of contacts; a board with greater turnover, and higher workloads; a board with 1 or 2 or more members who are there because you had no choice -- this is the new "blended family" at the table. The new challenge is redefining the "chemistry" they'll need to excel:

-- ***RDW***

6 WAYS BOARD PORTALS HAVE EVOLVED

After pushing board portals and board tech for years, I've looked around and realized that this new, gee-whizzy technology has grown into a healthy maturity. Since their first baby steps around the turn of the millennium, board portals have become a powerful tool for better governance.

However, that doesn't mean the board portals of 2014 are just more popular versions of those around in 2001. The capabilities, demands, technology and value of portals have all expanded radically. What do you need to know when evaluating online board portal options today?:

- Early board portals weren't -- portals, that is, at least not in the current sense. "What we call portals now were originally designed just to provide information to the board," recalls Jeff Powell, of major portal player ***Diligent*** (whose URL, "Boardbooks.com," hints at this history). Early players in the board portal field came from information management backgrounds, and had limited goals for what a "portal" should do. "In the early days the goal was just a paperless boardbook," says Brandon Korbey, of service leader ***Boardvantage***. With a sales pitch that the corporate secretary's back office functions would become easier, first marketing efforts focused on secretaries and counsels, which limited adoption.
- Over the years, as technology and user input advanced, these "boardbook e-delivery" tools evolved into ever more powerful board support tools. The NASDAQ OMX's ***Directors' Desk*** offered specialized tools for meeting presenters, notes and annotations. Boardvantage added surveys, bookmarking, the ability to open a number of board documents simultaneously, and secure e-signatures. Diligent included broad search capabilities for company info, questionnaires, and other tools (most of the major services share these capabilities today, btw). The result has been a transformation from one-way info dump to a board support matrix that literally is remaking how board's work (see our May article on "Board Meetings 2.0").
- Usage and capabilities of board portals expanded steadily for their first decade, but everyone in the industry saw a demand hockey stick jump hit around 2010-2011. "Even though the technology had become viable, most boards weren't ready to move," says Powell. The big X factor -- introduction of the iPad and other tablets starting in 2010. "Every board member seems to have gotten an iPad for Christmas in 2010, and that just flipped things on their head," Korbey remembers. Earlier, corporate staffs had been pushing boards to adopt board portal tech for use on their laptops. By 2011, directors were bringing their cool new tablets to board meetings and asking for apps they could use in governance. Portal sales jumped, and haven't slowed as directors seek new ways to bring governance demands to their tech toys. Recalls Korbey, "We added e-signature capability for iPhones because Marc Andreesen wanted to be able to do [board] approvals on his phone."
- On a related note, our experts find that boards now demand (and receive) broad, yet very secure, cross functionality between platforms and machines. Today's directors are always on the job. They must be able to access info and do board business on their desktop PC, their Android phone, or their iPad tablet, wherever and whenever. Providing seamless, secure flow between these gizmos is now a top selling point for the portals.
- Some of the early promises of board portals have faded, less from lack of demand than through governance realities. Back a decade ago, a selling point for portals were tools that would allow board members to communicate, collaborate and message each other. Our experts find this is usually shot down by legal staff, and most directors go along. Board members sending messages, discussing, and doing business in the online margins would be a compliance, disclosure and document retention nightmare. One of our panel recalls a company tech person wanting to keep a digital record of every time a board member accessed their portal. Counsel noted that, in litigation, such a log would be first in any plaintiff's list of discovery demands. Request denied.
- The future? Extending the portal model developed for boards to top groups of managers, such as executive committees, and also allowing more interface between the board and managers. Greater growth overseas -- the portal market launched in the US, but as global boards (and their global subsidiaries) make more use of it, international directors recommend the tool to their local companies. And soon, the use of board portals (at least by larger public companies) may become the governance standard. "If you're above a certain level, investors will ask why *aren't* you using a portal," suggests Powell.

BOARD/ INVESTOR DIALOGUE: STEVE WOLOSKY'S TAKE

With proxy season 2014 in the US past, it's time for post-mortems of both immediate and long-term shareholder/board proxy outcomes. One long-growing trend -- more discussion (and negotiation) between boards and activist investors. This isn't just the "more dialogue and communication…" blah-blah we've been hearing about. We're talking negotiation and back-and-forth between boards and investors, with high stakes.

One expert often in the middle of this dealmaking is Steve Wolosky, who heads the activist practice at name law firm Olshan, Frome, Wolosky. When the toughest activist investors in the US go into battle with corporations over proxy issues, M&A, or governance, they call Steve Wolosky. He recently negotiated a novel deal between US Auto Parts Network and major investor Timothy Maguire that requires the company to seat a director mutually agreeable to both parties. If both sides can't agree, Maguire joins the board himself.

I asked Wolosky how he sees negotiation dynamics shifting between boards and investors (and what clues he can give boards from the activist side). My comments follow his:

■ "Discussions have grown much more sophisticated now. From the activists' point of view, representation may be important, but it's just as important to get substantive change, which can include poor capital allocation, performance issues, or structural issues." (Boards need to dig deep to learn what an unhappy shareholder is *really* after, versus what may be negotiating chips or side issues).

■ On more direct board engagement with activists… "I'm on the activist side, but find differing situations need differing approaches. If the issue is the performance of management, it's tough to have dialogue with those managers on the topic -- it's hard to tell the CEO that the CEO needs to be replaced. In many situations, you'll need dialogue with a lead independent director, or the board chair." (This suggests you can gain an early read on the investor's beef from who they want to talk to. Most issues will start with management anyway, but if the first contact is directly to your board leader… the CEO may want to update his vitae).

■ "Boards usually bring in advisors, law firms, banks, other professionals, who encourage them to engage in dialogue, but again, it depends on what the substantial issue is about." (The smart board immediately gets outside help when an activist investor wants to talk with them -- the stakes are too high, and the negotiations too tricky too solely trust inside counsel).

■ "The number of campaigns is much larger today, and settlements are up. I'd say boards should engage in early, constructive dialogue [with the activist]. This can bring settlement early in the process." (Assuming that the board should hold off on discussion until management kicks it up to them is old style. Today, the board needs to get plugged into the issues from the start).

6 MUSTS FOR THE "VISIONARY" BOARD

The short-term horizon of many corporations has become an ongoing sore spot in business discussion. However, the "short termism" problem *itself* is along-term one. One of the first diagnoses came back in 2006, when investment pro association the ***CFA Institute*** assembled a group of CEOs, directors, analysts, IR people and other business leaders to research the issue. Their original report made headlines for raising the problem, but also for the finger-pointing among the group and outside commentators it prompted. In sum, short-termism was indeed a problem for American public companies -- but everyone else was to blame.

To drive solutions instead of alibis, the CFA group convened a new group focused on the role of the board in fighting next-quarterly obsessions. The result was an impressive study, ***Visionary Board Leadership***, available at the CFA website. The CFA has recently brought a broader focus to the findings of this report by calling out 6 specific areas public company boards must focus on to drive a long-term, "visionary" approach to governance. Following is a summary of these shopping list board needs, with added comments from CFA Capital Markets Director (and report author) Matt Orsagh:

■ On *quarterly earnings practices*, the visionary board… discourages quarterly earnings games by management overall… oversees the guidance process with a focus on long-term results, especially from the audit-committee level… sits in on quarterly earnings calls, and seeks its own info beyond that given by management. "One director recalled a case where the board meeting received a report on a stock price jump that happened that day," says Orsagh. "The board got all giddy about it, but the director realized that such a short-term pop wasn't really germane."

■ On *shareowner communication*, the visionary board… ensures mechanisms for investor input to the board… builds a culture of "constant communication" (*not* just when trouble strikes)… stays aware of the concerns of investors, employees, customers and other stakeholders, even when the news is bad. "Can the directors have a conversation on a specific issue, and are they prepared?"

■ On *strategic dire*ction, the visionary board… is actively involved in company strategy setting, and knows that its oversight is a continuous process… knows that an effective strategy must combine short-, intermediate-, and long-term elements… can intelligently defer to management on the implementation of the strategic plan. "Our panel wanted recommendations that were broad enough to be effective, but not prescriptive."

■ On *risk oversight*, the visionary board... knows that risk oversight is a whole-board responsibility…

understands the company's Enterprise Risk Management (ERM) plan… can clearly explain to investors the board's risk oversight role… knows that risk can't be eliminated, and *also* ensure strong crisis management planning.

- On *executive compensation*, the visionary board…works to align pay with long-term performance… knows what role risk-taking plays in the reward structure throughout the company… can communicate the board's compensation philosophy well to shareholders, and is active in prepping the Compensation Disclosure and Analysis (CD&A).
- On *company and board culture*, the visionary board… asks hard questions of itself and management… is aware of the "soft issues" culture of the company, and regularly interacts with employees below the top management level… wants to know about issues raised in ethics hotline complaints… is intellectually curious about the company. "One of the most interesting aspects of our report was the cultural part," notes Orsagh. "It's studied the least, but, in talking to investors, it's what they find most interesting. They said it was enlightening to have conversations with board members on culture. Directors are coached on things like compensation and strategy, but their comments on company and board culture are outside of what's prepared for them, and give insight."

REAL-WORLD TIPS ON LAUNCHING A NEW BOARD

Launching a board of directors is like launching a business -- the more times you do it, the better you get at the nuances and details. That's why I checked in with Jim Alampi. Alampi heads the ***Alampi & Associates*** management consulting firm in Michigan, and authored the recent book "Great to Excellent." But in reading his bio, I was impressed with his experience in setting up boards of directors as a serial entrepreneur, and past member of 20 boards, and chair of 4. What lessons did he learn the hard way about picking great board members?:

- "Even if you're a private or family company that doesn't have to, your directors need to be independent. That's the whole point. In the old days, directors were chosen because they were beholden to whoever asked them to join. Now, it's crucial to have someone who can pose tough questions. I found that might mean picking board members who can say 'no' to me. It demands strength of character, what Jim Collins wrote about as willingness to provide brutal facts."
- On judging a prospective board member in advance. "There are two things. One is past experience, how they handled themselves with past jobs and with old bosses -- were there times they took the right position rather than the easy one? Second, what are their core values? Do a deep dive on this during the interview. The right people with the right values can change all sorts of things."
- On qualities he values in a potential director. "Do they ask good questions? That is, questions that you never would have thought to ask yourself? Everyone has a blind side. I was on the board of a wholesale B-to-B distributor, and we were doing scenario planning, what worst case things could happen to our business. One director asked, what would happen if someone opened a Costco-type business to service our particular industry. We thought about it, and realized such a move would change our whole value proposition if customers decided to go shopping for themselves. Discussing that took up the rest of the board meeting."
- Why older, seasoned execs may not make the best directors. "I've often found that, by the time someone reaches the board level [in his career], innovation isn't a personal strength anymore. When they reach the board age, and have gotten to a senior level, they depend on the young Turks to come up with ideas."
- Dealbreakers? "If they seem to be doing it for the money or for the glory. By the board stage of a career, it's much more about giving back, watching progress and making strides for a company. You don't want them on the board for the glory, or just to tell their war stories."
- The most common flaw with entrepreneurial boards. "With entrepreneur boards, the founder was usually told by a lawyer, or CPA that they need a board. So they set one up, but have no clue on what a board really means. The founders have to give up some decisionmaking powers, and they just can't stand that"

ONLINE FIND: CHEVRON'S CORPORATE SECRETARY ON BOARD PERFORMANCE

I spend a lot of time mining the internet for useful info on better boards, and sometimes other publications deliver a particularly good find. ***C-Suite Insight***, a journal from the consulting and compensation pros at Equilar, recently offered an insightful interview with Lydia Beebe, corporate secretary and governance officer at petro giant Chevron, on her work in helping their board strengthen its performance. Of special interest are her tips on making board evaluation and board/investor engagement work. Favorite quote: "Being the corporate secretary is like playing goalie. You have a lot of chances to get scored on and very few chances to score." Check it out.

Q&A: Are These Directors Too Distracted?

Q: *The latest financing round for our company added a couple of board members representing the investors. Both have strong backgrounds in our technology and in financing, but both are also active in a number of other startups and venture company board situations. They offer valuable, if brief, insights as directors, but aren't very responsive outside of board meetings, rarely responding to messages. I can't tell whether this means they're so savvy that the least input is gold, or if they're just too busy for us. How can you tell if a director is overstretched?*

A: This is a tricky call, especially since investment means these folks aren't leaving your board table any time soon. But a director's contribution means more than just dropping a pearl of wisdom every couple of months or so and then checking out until the next time. A distracted director nowadays is a dangerous as a distracted driver. Her are a few tests you can watch for:

- You say both are "very active" outside of your board, but do you know how active? Good governance, even for venture companies, means having detailed vitae on board members, if for no other reason that to watch for conflicts. Compiling and reviewing a list of these members' other boards (particularly any public companies), representations, or non-profit involvements could confirm your fears.
- Can the director keep all his boards straight? One long-time director recalls serving on a board committee with another very active director who chaired the committee. At the full board meeting a few days later, the committee chair read off his committee report -- and it slowly dawned on the long-time director that this guy was reporting on another committee he chaired *at a completely different board*. When your directors give input, do they ever seem to mix up names, clients, initiatives? Does it take them a few minutes at the board meeting to focus on you?
- Overstretched board members may have a good attendance records for full board sessions -- but how about committees? These are more likely to be sacrificed to the busy director's schedule, particularly special committees or ad hoc meetings. Check attendance over the past few months to confirm.
- Another clue -- how much interaction do these busy directors have with other board members, and with the board chair? Look not only at interaction quantity, but quality. Is there give and take, and questioning? Do they have good chemistry with you and the rest of the board? Or are relations brief and perfunctory?
- Sometimes distraction can be obvious. Are these the folks who spend in-meeting time messaging and taking calls from the outside? When an in-person meeting convenes, do you get the impression that this is the first time these directors have looked at the board material?

Final question -- what can you do about it? If the above tests suggest these directors aren't contributing, the first step if for the board chair to engage in a cup-of-coffee private chat with each. Don't hit them with the data above at first, just express a view of the board that you're missing out on the insight they have to offer. If the message you deliver is that you need more of the wisdom they can provide, ego should win out over their day planners.

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RALPH WARD'S BOARDROOM INSIDER is published monthly for directors, CEOs, those who work with corporate and nonprofit boards (corporate secretaries, corporate counsel, support staff, and consultants), and those who are board prospects.
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