1.

From Ceremonial to Monitor to Leader

The authors of this book have occupied a front-row seat for seeing the gap between boards that are well run and led and are boons to the companies they serve, and those that are far less so. We have seen how public agencies and governance activists have sought to close that gap by insisting on tougher rules, check-the-box lists, and tighter regulations. We believe, however, that much of the variance stems instead from a very different source: the human dynamics, social architecture, and business leadership of the board itself.

We seek as a result to focus attention on building more engaged leadership in the boardroom, not just the executive suite. The manifesto that follows makes an uncomplicated argument to that end: *Governing boards should take more active leadership of the enterprise, not just monitor its management*. For the reasons behind doing so, the principles of how to do so, and the costs of not doing so, read on.

In bringing this argument to life, we make it pragmatic and we keep it short. And along the way, we expand the working concept of corporate governance from one of shareholder oversight to director leadership of the most vital company decisions. To do otherwise, we believe, is an opportunity lost, a responsibility abdicated.

We also believe that many of the thrusts of government regulators, activist investors, and governance raters have focused on the wrong issues. Rather than being concerned with whether the chief executive should be the same person as the board chair or whether directors should have staggered terms, we worry more about whether the board leader can help direct the board in setting strategy and gauging risk in concert with the CEO, and whether the directors' talent and collective chemistry make the board a substantive player at the table.

We identify a distinctive social architecture that is now required of companies if directors are to lead the enterprise along with executives, not just stand guard over it. This calls for a different kind of vigilance in the boardroom, a deeper kind of relationship between directors and executives, and a new kind of leadership from both.

The emergent model is a result of forces not of its own making. Increased regulation, shareholder pressures, and governance reforms over the past decade were intended to strengthen the board's oversight function. Yet as boards have become better monitors, they have also become better leaders, delving into a host of other areas that had been delegated to management in earlier times. We believe that directors can and will more actively lead in the years ahead, and on balance we anticipate that this should fortify company performance. But that is not a given. Poorly handled, this new board enablement can cause serious damage, resulting in fractured authority and dangerous meddling.

We seek a practical road map for knowing when to lead, when to partner, and when to stay out of the way. In developing it, we are less concerned with theories of corporate governance or ratings of good governance and more focused on the practical steps that directors and executives can take to make their collaborative leadership most effective.

A New Model of Collaborative Leadership

In a 2002 letter to Berkshire Hathaway shareholders, Warren Buffett famously lamented his multiple derelictions of duty as a director of some forty corporations over nearly two decades: "Too often I was silent when management made proposals that I judged to be counter to the interest of shareholders," Buffett wrote. "In those cases, collegiality trumped independence [and a] certain social atmosphere presides in boardrooms where it becomes impolitic to challenge the chief executive."[1]

A decade later, Amgen chairman Kevin Sharer painted an almost opposite picture of the relationship between board and corner office: "You're a lion tamer and they're the lions. Respect them, but if you let them eat you, they will. Working with the board is vital, complex, and beyond your prior experience—unlike anything you've done before. It is among the most complex human relationships, especially if you're the chairman, when you're their boss, and they're your boss. Get the relationship right, or it will hurt you."[2]

Allow for a little hyperbole on both sides—Warren Buffett was never *that* neglectful, and Kevin Sharer carried neither whip nor chair to keep his directors at bay. Still, the difference between the two observations illustrates a striking reconfiguration taking place in how boards operate and how company directors work with top management: the emergence, in an extraordinarily short time, of the potential for boards to be a vital leader and new force in corporate governance.

But note the qualifier—*potential.* This leadership capacity has yet to be fully exploited or even realized at many firms. Too often, directors remain one of the most valuable but least utilized of a company's assets. Smart, experienced, and dedicated men and women are ready to serve. They are sworn to protect and advance the enterprise, to ensure that it does what is best for customers and investors. Yet their wisdom and guidance are still too often closeted in the boardroom.

But the prevailing model is changing, and quickly. At company after company, boards and management have been embracing new practices that help define a more directive, more collaborative leadership of the firm. They are taking charge of CEO succession, executive compensation, goal choices, merger decisions, risk tolerance, and other functions that have traditionally been the province of management.

Based on our work, interviews, and research with executives and directors of multiple *Fortune* 500 firms ranging from Agilent Technologies and Boeing to Infosys and Pfizer, and their equivalent in other countries, *Boards That Lead* maps out what active leadership of both directors and executives should look like. We have drawn, for instance, on interviews with Procter & Gamble CEO A.G. Lafley on how his board shaped its $54 billion takeover of Gillette; with Apple board leader Edgar S. Woolard Jr. on how he secured his directors' agreement to bring Steve Jobs back to run the firm; with Ford board leader Irvine O. Hockaday Jr. on the directors' recruitment of a turnaround chief executive; and with Lenovo chair Liu Chuanzhi on how he transformed his board to globalize the business.[3]

What follows is our mapping of an emergent model of company leadership, one increasingly defined by the actions of both executives *and* directors. We draw the map by looking inside and around boardrooms, and in doing so, we witness moments of both great and disastrous leadership.

If you are already on a governing board or aspire one day to join one, our account can serve as a boardroom companion. If you invest in publicly traded companies, analyze them, rate them, regulate them, or consult with them, this book will reveal an emergent dynamic of the boardroom. And if you work with a board as a manager reporting to it or soon will be doing so, our account can inform your work with directors who are often ready to embrace a more proactive leadership role. Our book builds on the tangible experience of directors and executives in the boardroom to offer better navigation through it, and it closes with a set of director's checklists for leading both the boardroom and the company.

Though the emergent argument is largely rooted in the American corporate experience, the same logic, we believe, should certainly apply elsewhere. The rationale would extend as well to small and medium enterprises, nonprofit organizations, and even public agencies overseen by a board of some kind—regardless of national setting.[4]

This rising power of the new model outside the United States can be seen, for instance, at Barclays PLC, one of Britain's premier financial services institutions, when it was swept up in a scandal in 2012 over its improper setting of LIBOR (the London Interbank Offered Rate). The government forced the board to dismiss both its non-executive chair and its CEO, and the company came under criticism for directors who fell far short of their duties. When the Barclays board brought in Sir David Walker—a former government official, author of a report on governance in British banking, and chairman of Morgan Stanley International—as its new non-executive chair, he promptly declared that boardrooms "have been too reactive, passive and accepting of what's proposed by the executive." Disagreements in the boardroom are still seen by too many as "discourteous," warned the new Barclays chair, and he vowed that he would end that reflexive mind-set.[5]

We agree. That does not mean directors should wade into micromanagement, but it does require directors to educate and interest themselves in company strategy, risk management, and talent development. And it calls for effective leadership of the board *by* the board. This may seem disconcerting to some chief executives used to more passive boards still focused on monitoring management, but we believe that most executives will come to embrace the principles of a leadership partnership.

"One of the Greatest Business Decisions of All Time"—by the Board

Our revised conception of corporate governance was early evident in one of the highest-payoff leadership decisions of the modern era, an atonement for an earlier, irresponsible board blunder. The Apple board had fired the wrong CEO.[6]

Pushed out in 1985, Apple founder Steve Jobs moved on to other start-ups, NeXT and Pixar. NeXT never took off, but by 1997, Pixar was prospering while Apple was failing. That is when one of the authors received a telephone call from Apple's board leader, Edgar S. Woolard Jr., who had joined the governing board in 1996.

The board decisions described at Apple, as for a number of boards in the pages that follow, are largely drawn from personal interviews that we have conducted with those in the boardroom, in this case primarily with board leader Woolard. He had been chair and chief executive of DuPont and director of Citigroup, IBM, and the New York Stock Exchange. A onetime army officer, he had become a consummate member of the inner circle of the business elite, including a period as chairman of The Business Council, one of the most select assemblages of corporate leaders in the country. He treated all with dignity, putting people first, though never at the expense of sound business judgment.

In the twelve years since the Apple board had forced Jobs out, the company had recruited three CEOs. One had been an advertising manager, another a cost-cutter, and the third a process engineer. Each had presided over a string of disastrous product releases. When one of us (Ram Charan) subsequently taught a business case on Apple, executive program participants almost always blamed the firm's decline on poor leadership in the corner office. But in our view, it was the board that had recurrently selected the wrong CEOs for the office—in effect, the chief executives were dead on arrival. A solid pedigree from past performance had made them attractive managers, but their skill set proved a poor match for the triage they actually had to perform.

Upon joining the board, Woolard spent hours with Apple's senior leaders to learn the specifics of the company's state of affairs. As CEO of DuPont, he had always made a point of having direct contact with people throughout the organization so he would not fall victim to information filters. He took the same approach as an Apple director, talking directly with the CFO, the head of HR, and the chief technical officer, because, he told us, "no matter how good the CEO might be, you're getting filtered information." His initial impression of CEO Gilbert Amelio was positive; the chief executive was a great talker and had big ideas. But the CFO was privately painting a gloomy picture of Apple's future, one that darkened in the months to come. At the annual meeting in February 1997, the disconnect between the CFO's acute concern and the CEO's rosy outlook came into sharp focus, and it clicked in Woolard's mind that the newest CEO was simply unable to confront a very grim reality. The chief legal officer conducted most of the meeting and fielded plenty of tough questions, while the CEO was conspicuously missing. Then Amelio took the stage and talked about how great things were going. Yet the arena was full of unhappy people lined up six deep behind four floor microphones, eager to voice their complaints about service, quality, and the lack of competitive products. It was the most disruptive annual meeting Woolard had ever seen. Amelio tried to respond, but his answers were far from confidence building. Woolard's wife leaned over to whisper to her husband a prescient observation of her own, "This guy doesn't know what he's talking about."

The company was nearly out of cash, having lost more than $800 million on annual revenue of $9.8 billion. Informed outsiders noted that Apple had a strong brand and a small band of die-hard customers, but many doubted if it had a future. Woolard, always probing, called Charan to ask if the company could be saved. There was no silver bullet, Charan replied. Then Woolard asked, could it be acquired? Would Dell Computer be interested in buying Apple? Though in the same industry, antitrust opposition was unlikely, since Apple was otherwise hurtling toward bankruptcy.

Charan checked with Dell vice chair Morton L. Topfer, only to hear back two days later that his company was not interested. Michael Dell would tell several thousand technology executives at an Orlando exposition that Apple should "shut it down and give the money back to the shareholders."[7]

Woolard then asked about Compaq Computer, and Charan's call to CEO Eckhard Pfeiffer yielded the same response. Others evidently shared similar appraisals. Nobody—not AT&T, not IBM—seemed the least bit interested in purchasing Apple. The only real prospect appeared to be a Taiwanese firm that might offer as much as $500 million, though mainly for the brand.

In the meantime, Woolard continued to dig into Apple's operations, reviewing in depth the firm's cash flow, product sales, and resource allocation with CFO Fred D. Anderson in weekly one-on-one meetings. The CFO's candid data-driven appraisals were dire in their implications. The company had too many products attracting too few customers, a licensing strategy was diluting its brand, and it felt rudderless at the top. Divestiture seemed the only way out. Woolard authorized the chief financial officer to retain Goldman Sachs, saying "Fred, we've got to find out if we can sell the company." By late May it was clear: they could not.

Woolard pressed the chief executive again and again to explain specifically how he would return the company to profitability. Around the same time, Woolard was learning from his private conversations with both the chief financial officer and the general counsel that Amelio rarely left his office or talked to people. In June 1997, the CFO warned Woolard that essential personnel were resigning or intimating they would soon be doing so. Woolard finally took the deepening crisis to a mid-June board meeting. In his estimate, if the board stayed with the same CEO, he warned his fellow directors, the probability of bankruptcy was near 90 percent, and even if they could find a buyer, it would nonetheless remain as high as 60 or 70 percent.

Despite three successive CEOs' dismal track records to that point, Apple's directors still believed that the company might be saved by the right executive. How to save it—or who could save it—had become the pressing question, and Woolard was flirting with a novel answer. Steve Jobs had become an adviser to Apple after its purchase of NeXT, so he had been on the scene talking to various people, including the CFO. In early May 1997 Woolard asked the board for authority to talk with Jobs about the possibility of his fully returning. "I think he'll come back," the CFO had already informed Woolard. "He is really getting involved in the company," explained the CFO. "He's got lots of ideas; he's talking to a lot of people."

Drawing on Woolard's own experience-honed instincts that the CFO had been offering candid advice without ulterior motives, Woolard told the board, "I think he's our only hope . . . I don't see any alternatives." Jobs was enthusiastic about the company, though he quickly added that it had way too many products and in any case they were all "crap." At Woolard's request, the general counsel arranged another board meeting in mid-June, and the directors then decided to fire the latest CEO and approve the rehiring of Jobs. Amelio resisted at first, but soon accepted his fate.

Jobs's mercurial and sometimes abusive behavior was already legendary. He had been out of the Apple game for a dozen years, and he could hardly have been more different from the lead director who was planning to recruit him. Jobs had dropped out of college, meditated in India, experimented with LSD, and clashed with virtually everyone he ever did business with. Woolard traveled the corporate byways with aplomb; Jobs broke china along the way.

But despite their vast personal differences, Woolard, with the board's backing, called Jobs: "We need you to come back." Woolard appreciated the gravity of the moment. The "grace of the Lord has dropped me down in the middle of this damn thing," he recalled, "and I'm just not going to let it go down if I have to piss everybody off and beg Steve Jobs to come back." Jobs refused to return as chair or CEO, saying only that he would return as an "adviser" until the board could find another CEO, but that was enough for the moment. He refused to accept any money or stock options. "I do not want anybody in Apple to think I'm coming back to make money," Woolard recalled Jobs explaining. "I'm coming back because I love this company, it's in big trouble, and I want to get it on the right track." He also stipulated that all the board members but Woolard resign, though he and Woolard settled on keeping one other, Gareth Chang.

The directors gathered in mid-July and invited Jobs, who had been sitting outside the room as the board met, to join them inside. After a pleasant "Hi, everybody" as he strode in, Jobs took a seat at the head of the boardroom table. Woolard said, "Okay, you know why we're here. Everybody has to resign except Gareth and myself." The other directors all confirmed that they would resign and walked out of the boardroom with no sign of rancor. They shook hands with Jobs as they left, some no doubt relieved to go, according to Woolard. Jobs wanted two new directors on the board—Oracle CEO Larry Ellison and Intuit CEO William V. Campbell—and Woolard wanted former IBM CFO Jerome B. York to join as well.

Bringing Steve Jobs back was an act of leadership that Woolard and the board should not have abdicated, and they did not. Then Woolard stepped forward to provide substantive guidance in the months ahead. Jobs came to Woolard for a discussion of what to do about the "clones," for instance, the computers that Apple had authorized other makers to produce that were now depressing the price of Apple's own Macs: "I've got to get rid of the clones," Jobs warned Woolard. "I can't get it going without that." Woolard cautioned against breaking long-term contracts with the clone makers, but Jobs insisted. "I don't care, Ed, I'll just have to pay whatever it takes to settle. But I need to call them to say they're out of business." Looking back on that decision, said Woolard, it was "pretty tough, but he was right."

Another week, Jobs sought advice on a plan to dismiss many of the company's engineers. "Ed, I really want to fire about half the engineers," he declared in a call. "I just can't see how we can do that," Woolard countered, but Jobs was adamant. "I've been here long enough now. I know who are really the talented ones."

Jobs and Woolard soon talked again about another Jobs proposal—to divide the company's remaining engineers into half a dozen teams in a way that would allow him to work one full day per week directly with each of the teams. "I can't work through a hierarchy," Jobs explained, "I know I can make that work because I need to put my personal involvement in everything that's going on." After an hour's discussion, Woolard finally OK'd the move. "Well, it's very unorthodox," he told Jobs, "but I do understand that you're the guy with the ideas, so go ahead. If the bureaucracy is weighing you down and this is the way to get to the best people and to get them functioning [then make the changes]."

At another point, Jobs came forward with an employee profit-sharing plan that would reward staff handsomely in several years but yield them little in the current year, a plan that Woolard strongly advised against (and that was eventually dropped). On several occasions, they talked about hiring a vice president from Compaq—Tim Cook—who had previously worked for a dozen years at IBM. They deliberated Cook's salary and title, and Jobs finally hired Cook with Woolard's blessing in 1998 (Cook would later become Apple CEO shortly before Jobs's death in 2011). In time, Woolard and Jobs would frequently engage around a host of other senior hires, their compensation, and their reporting relationships.

Later, Woolard and Jobs talked about the possibility of creating an Apple store. "I want to build an Apple store," Jobs asserted, but Woolard initially demurred: "Compaq's done that, others have done it, and everybody's failed." Jobs countered, "I've thought about it a lot, I think we can do a chain of Apple stores which would be unbelievable." They argued for another half hour, and Jobs finally said, "Approve for me to do four. Give me the money to do four. If you're right and I'm wrong, I'll quit," adding, "I'll take the medicine and say I was wrong." With Woolard's urging, the board approved the opening of four stores. "This is going to be a retail store like you've never seen," said Jobs.

Looking on their many weekly calls, Woolard observed that despite a few misses, "90 percent of his ideas were damned good." Other board members jumped into an active partnership with Jobs as well. For instance, new board member Larry Ellison provided feedback on computer design. In reflecting on the board's active relationship with Jobs, said Woolard, "It was not arm's length at all."

Through it all, Woolard had found Jobs to be respectful of those both above and below him. Though Jobs brought a strong point of view as to where Apple should be going and how it should get there, he worked well with the reconstituted board. Woolard had built relations with managers deep in the organization, but he heard few complaints from below about Jobs's behavior inside the firm and never personally witnessed his anger, arrogance, or imperiousness. Symptomatic of the special deference that Jobs had come to show Woolard himself, when the CEO telephoned the board leader's home and Woolard's wife would answer, she would sometimes call her husband to the receiver with the information, "Your *son*'s on the phone."

In the years ahead, Woolard found Jobs to be a "well-balanced, good CEO" of the company, and he noted that virtually none of the vital people hired by Jobs ever left the enterprise. "Steve Jobs is not just a creative guy," Woolard reflected of his work with Jobs, but he was also "a good leader of the board, he was a good leader of the company."

The company returned to prosperity, and Ellison declared at a board meeting several years later that the board was both the smartest and the dumbest in America. Directors had hired the best CEO in the country, and company stock had now risen by a factor of ten. But at the same time, they were still paying the CEO nothing—Jobs did, however, ask for a company-purchased Gulfstream jet because of his travel demands. Woolard and his fellow directors approved the aircraft and added that if Jobs could double the market cap of the company—it had by then already reached $16 billion—the board would give him a stock option grant equivalent to 5 percent of the increase, some $800 million.

In recruiting, coaching, and retaining Steve Jobs, Apple directors transformed a struggling $2 billion market value company on the verge of bankruptcy in 1997 into a company with a $500 billion market value just fifteen years later. Though they developed deep knowledge of the company and worked closely with Jobs, directors resisted the temptation to micromanage. The board's decision to hire Jobs has been ranked as one of the "greatest business decisions of all time," and Jobs would later say that the lead director who spearheaded it, Edgar Woolard, "was one of the best board members I've ever seen" and "one of the most supportive and wise people I've ever met."

When we asked Woolard about the most important lessons from his Apple experience, he reported that a board leader has to have regular access to the chief financial officer, deeply understand the company strategy and execution—and pick and partner with the right CEO.

Monitor *and* Leader

To appreciate the leap in board behavior that the Apple directors revealed—and the rising leadership content in the board's role at many companies—we take a step back to a brief retrospective on governing boards themselves.

For more than a century, American companies have been creating and sustaining boards of directors, a noble concept and one required by state laws and regulated by federal rules, to ensure that the controllers are controlled. Everybody needs a watchdog, if for no other reason than to be accountable to someone.

As the country's great franchises took form in the later part of the nineteenth century and early years of the twentieth century—General Motors, Johnson & Johnson, and Procter & Gamble among them—they initially filled their boards with family members, wealthy investors, and a liberal sprinkling of FOFs—friends of the founder. Not perfect overseers, but many if not most of them held a personal stake in the firm's commercial success and they predictably worked to achieve and protect it.

Until the 1930s, most American companies remained family owned, their boards dominated by owner-managers. It was often impossible to distinguish insiders—managing directors—from outside directors, but the distinction was largely moot in any event. If you were a director, you were likely a de facto insider because of your shares or investment in the company, or your position as a manager of the enterprise with a significant personal financial stake, as is the case with the boards of many private-equity-backed firms in America today. Or you were an insider by virtue of your kinship or friendship with the founding family.

Then came the celebrated "managerial revolution," chronicled by Adolf Berle and Gardiner Means in their landmark 1932 book, *The Modern Corporation and Private Property*. Rapidly growing companies in need of additional funds to stoke their engines took to the equity marketplace by going public, and the "modern corporation" emerged, defined by Berle and Means as the absence of "dominant owners," where "control is maintained in large measure apart from ownership."[8] Professional executives triumphed over the founders and their heirs. Expertise trumped pedigree. In the wake of the revolution, the locus of authority shifted from owner-managers to trained technocrats.

Boards were still adorned with what the British call "the great and the good"—individuals of great stature and impeccable reputation. But their powers had been upended, even eclipsed, by professional managers who now had their hands on the brakes and throttles. Directors met too infrequently, understood too little, and held too few shares to make, or even want to make, a difference. With stockholding widely dispersed among thousands of investors, none with sufficient clout to demand otherwise, boards became more ceremonial.[9]

Duties of Care and Loyalty

By the 1980s, however, dispersed shareholding was fast becoming far less dispersed, with public equity increasingly moving out of the hands of widows and orphans and into the hands of a relatively small set of mega-investors. In 1950, a mere 6 percent of US corporate equity was held by institutional investors; a half-century later, that fraction had grown tenfold. The growing concentration of shares in the hands of professional money managers became even more pronounced among large publicly traded firms. In 1987, institutional investors held 47 percent of the shares of the thousand largest American enterprises by market capitalization. By 2009, that fraction had risen to 73 percent.[10]

At first, massive investment-fund managers such as CalPERS, Fidelity, TIAA-CREF, and Vanguard chafed at their powerlessness, despite their massive holdings, to prevent companies from imploding—or even just plodding along. But then, as their assets accumulated and with an intellectual boost from financial economists, institutional investors sparked what came to be known as the "market for corporate control"—investor-driven takeovers and restructurings of poorly managed firms.[11]

These and a host of other investor pressures ranging from proxy fights to quiet negotiations rejuvenated the boardroom, bringing director oversight of executives—now on behalf of major institutional shareholders—back to life. The board's monitoring function had always been there in name. Now it was becoming established in fact.[12]

During the 1990s and the first decade of the new millennium, shareholders further strengthened their powers, but most major investors still dispersed their holdings across a large portfolio of corporations, leaving the institutions with little time or individual incentive to weigh in on the competitive challenges or operational shortcomings of any one of them. Some activist investors did begin to take on issues ranging from how to pay a CEO to whether the board should have a non-executive chair, but they often tended to focus more on standardized form and less on strategic function.[13]

Inevitably, investor demands for more independent boards that would be accountable to them, paid like them, and fiduciaries for them gave rise to litigation. To investors' dismay, challenges in the Delaware courts—where half of the country's largest firms are incorporated—even to what shareholders considered the most egregious violations of owners' interests, often did relatively little to force behavioral changes at the top. But the legal actions did help establish two standards for director obligation: *duty of care*, requiring directors to exercise reasonable caution in executing board responsibilities that could harm others if not performed well, and *duty of loyalty*, requiring that directors exercise good fiduciary judgment on behalf of the stockholders.

These dual obligations of care and loyalty were further strengthened by the Sarbanes–Oxley Act of 2002, new rules imposed in 2003 by the New York Stock Exchange, and the Dodd–Frank Act of 2010. Collectively, the three measures served to empower directors as overseers, with the goals of preventing executive self-dealing and excessive risk-taking, all in the name of better shareholder monitoring.

The Sarbanes–Oxley Act, for instance, holds directors responsible for ensuring that their company has internal financial controls in place and does not violate accounting rules. Dodd–Frank instructs the Securities and Exchange Commission to create procedures that make it easier for shareholders to propose and elect their own nominees to a board, facilitating stronger director oversight of managers on behalf of owners. And the New York Stock Exchange requires that all members of the board's audit committee be "financially literate" and "independent," and that their duties include "oversight [of the] integrity of the company's financial statements."[14]

Such regulatory measures, while their implementation has not always been smooth, have significantly sharpened the board's role as monitors of management. Plenty of evidence confirms that boards have in fact come a long way from the ceremonial status in the earlier era of managerial dominance. Though that status persists at some firms, it has been eclipsed at many.[15] To cite several key developments:

- The governing boards of more than nine out of ten of the S&P 500 (Standard & Poor's five hundred largest companies as ranked by market value) now have a lead or presiding director, as required under new listing rules.
- The percentage of company boards with separate board chair and chief executive had risen to 43 percent by 2012, though only 23 percent of the chairs can be deemed truly independent of top management.[16]
- The proportion of firms with so-called "poison pill" devices, designed to protect management from hostile investor takeovers, declined from 59 percent to 8 percent, while the fraction with *classified boards*—on which directors serve staggered terms, presumably making them less subject to shareholder pressures—declined from 61 to 20 percent.[17]
- Executive pay has been steadily migrating from fixed salary and benefits toward contingent compensation that varies with financial results that directly benefit shareholders. In 1982, a manufacturing executive arriving at work just after the New Year could expect to receive at least 63 percent of his or her pay by the end of the calendar year, regardless of company performance for shareholders. By 2012, that fixed fraction had dropped to 20 percent, and long-term incentive-based compensation, largely tied to shareholder value through stock-based pay plans, had jumped from 17 to 61 percent.[18]

Duty of Leadership

These and related trends have helped boards become far more effective monitors of management than they were a decade ago, and in doing so they inadvertently strengthened the board's leadership hand. And still other trends, we believe, are now helping boards become even more engaged in the task of leading the company, though it is a transformation still in process and one that will not happen entirely on its own. Indeed, one of the premier callings of both directors and executives now is to further facilitate the transformation, building on pioneering advances at other companies and market trends that are inexorably making board leadership more imperative. While the duty of care and the duty of loyalty have become critical to the directors' monitoring function, the additional responsibility, a *duty of leadership*, is becoming essential as well.

The most forceful underlying trend behind the intensifying obligation of leadership is the increasing complexity of company decisions across virtually every facet of doing business, from sales channels and product categories to price points and product markets. Consider wireless carriers. Early entrants focused on just several demographically distinct markets, but later incumbents came to distinguish some two dozen or more submarkets. The number of mobile phone plans rapidly expanded as well to include prepaid, postpaid, night, family, friends, family and friends, data, and text plans. Wireless carriers sold through as many as a dozen separate channels, ranging from company-owned stores to affinity partners and websites, and the industry embraced as many as a half-million distinctive price plans.[19]

A related challenge has been rising *information overload*, a condition in which the addition of ever more information leads to suboptimal company decisions rather than improving decision quality. Imagine an inverted U-curve: as data initially becomes more available, decision accuracy improves; but beyond an inflection point of increasing information, the amount of data diminishes management's capacity to process the information and thus its ability to reach optimal decisions.[20]

Yet another source of complexity: the increasing movement of enterprise operations or sales across national boundaries and the concomitant need for company managers to be conversant with multiple—and often widely diverse—regulatory regimes, consumer preferences, and cultural traditions. In 2001, foreign markets accounted for 32 percent of total sales of the S&P 500 companies. By 2011, that figure stood at 46 percent, approaching half of all sales and up 40 percent in a decade.[21]

That growing complexity has become increasingly of concern to company management. IBM has periodically asked a cross section of managers at a wide range of companies to identify their greatest challenge. In the surveys of 2004 and 2006, managers gave top place to coping with change. By 2010, however, the more than fifteen hundred managers that IBM surveyed in sixty countries reported in the aggregate that "complexity" had emerged as their leading concern. What is more, nearly four of five anticipated even greater complexity in the five years ahead, and only half said that they felt "prepared for the expected complexity." Four out of five of the polled executives also responded that the most important quality of leadership for the next five years would be executive "creativity" in dealing with that complexity.[22]

While some of these developments are more operational than strategic—and thus for executives rather than directors to address—they reflect an ever-broadening challenge for board members. With increasing complexity in how markets operate and with sharper bends ahead, a greater premium is placed on understanding how these uncertainties can create opportunity or, conversely, destroy value.

Still other evidence suggests that boards are, in fact, rising to this challenge. Spencer Stuart periodically surveys corporate secretaries and general counsels at S&P 500 firms regarding the areas that require the greatest board attention. In 2008, "shareholder concerns" nudged out "company strategy," but by 2012 the results had flipped: company strategy topped shareholder concerns by better than two to one.[23]

The directors' duty of leadership as a result is ascendant at many companies. We delve into this in greater detail as we go along, but here are four starting points:

- Directors and executives increasingly view the boardroom as a place where they can mutually engage in reaching critical decisions for the company.

- While boards are still obligated to the duties of care and loyalty—their vigilance on behalf of investors must be honored—

many boards have been adding a new obligation, focusing director attention on company strategy, capital allocation, executive succession, management compensation, talent development, and enterprise risk. That does not mean wandering into the weeds—micromanagement is decidedly *not* the point—but laissez-faire is no longer an acceptable posture at many boards either.

- In selecting a new chief executive officer, boards are becoming more mindful of both their monitoring and leadership roles. This points toward selecting a new CEO who has a tangible record of creating shareholder value, either within the company or in another firm, though not necessarily as a chief executive. And it also points toward a new CEO who has also displayed a capacity for working hand in hand with governing boards.
- In building the leadership at the top, executives are increasingly furnishing directors with the information from both inside and outside the firm required to reach strategic decisions, and directors are increasingly conveying their strategic intent to guide executives in taking clear-eyed actions.

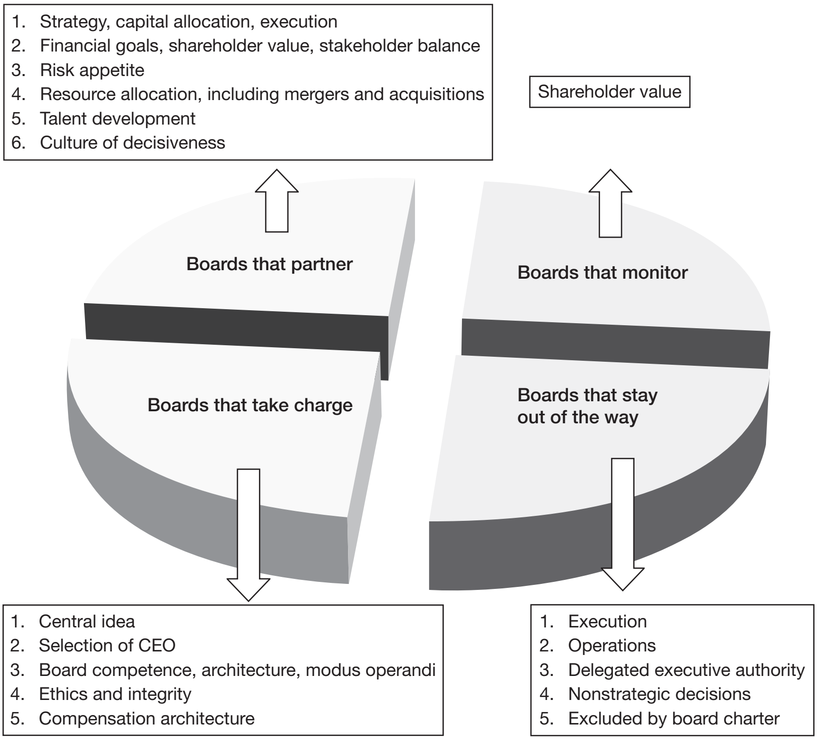
That last item in particular points to the key ingredient in making this new model work. In certain leadership areas, such as selecting a new chief executive, directors tend to drive the process, as we have seen at Apple. In other realms, such as setting strategy and developing leaders, directors and executives often work collaboratively with executives more at the wheel. And in still other areas, directors wisely avoid any involvement.

When to Lead, When to Partner, and When to Stay Out of the Way

Each company board will want to fashion its own unique blend of the components of direct and collaborative leadership. "Boards should sit down" annually, urged Ford's lead director Irvine O. Hockaday Jr., "and say, OK, what are we really doing here, what really is our role given the situation of this company at this time, what are we doing to incarnate that role, how are we going to function with the lead

FIGURE 1-1

Boards take charge, partner, or stay out of the way



director, and what are our priorities?" Finding the right balance among the board's leadership components—knowing when to lead, when to partner, and when to stay out of the way—is one of the premier tasks of the board's leader.

Our road map, and the foundations for this book, are shown in figure 1–1.

A duty of leadership also implies that directors should remain steadfastly detached from the products of their labors. Though now far more deeply engaged in the company's strategy and other practices than ever implied by the monitoring function, directors nonetheless must also be able to back away from a path that they have had a direct hand in mapping. That is never easy of course, but the prescription here is clear: leadership by its very definition implies that directors resolutely focus on what is right for the enterprise, regardless of personal pride or sunk investment. A useful dictate to keep in mind: *mission first*, or in Peter Drucker's well-known phrasing, "Leadership is doing the right thing"—regardless of commercial interest or personal pride.

Our assessment does not imply that executives are any less in the driver's seat. But the way that they drive at many companies is now markedly different—a shared or distributed leadership model that is better suited, in our view, for guiding companies that are facing more uncertain, more changing, and more complex markets.[24]

The Director's Checklist

We believe that executive leadership can be mastered and that a leader's checklist can focus mastery on the most vital principles for navigating through virtually any leadership challenge. We have similarly come to conclude that much the same kind of director's checklist can be important for boards to lead as well. A set of enduring checklist principles can furnish directors with a road map for leading through the most challenging moments that boards inevitably confront.[25]

From watching dozens of governing boards in the United States and elsewhere, we are convinced that their experience points to a relatively modest number of emergent mission-critical leadership principles. Albert Einstein said that the calling of physics was to make the natural universe as simple as possible—but not simpler. The director's checklist is likewise at its best when it is as bare bones as possible—but not more so.[26]

Here is our first checklist for the decisions that directors will want to lead, the decisions where they will want to partner, and the decisions where they will want to stand clear. The chapters that follow conclude with additional director's checklists, and we gather all of these mission-critical templates, as well as some valuable extras, in "The Complete Director's Checklists" at the end of the book.

DIRECTOR'S CHECKLIST FOR LEADERSHIP DECISIONS

When to Take Charge

- ✓ Central idea
- ✓ Selection of chief executive officer
- ✓ Board competence, architecture, and modus operandi
- ✓ Ethics and integrity
- ✓ Compensation architecture

When to Partner

- ✓ Strategy, capital allocation
- ✓ Financial goals, shareholder value, stakeholder balance
- ✓ Risk appetite
- ✓ Resource allocation
- ✓ Talent development
- ✓ Culture of decisiveness

When to Stay Out of the Way

- ✓ Execution
- ✓ Operations
- ✓ Areas of delegated authority
- ✓ Nonstrategic decisions
- ✓ Excluded by board charter

Companies vary greatly in how they specifically work to enhance the board's hand, customizing their architectures and practices around their own specific histories and mind-sets. Within a given board, directors also vary in their conversational intelligence—their ability to advance the boardroom dialogue in ways that serve company leadership. We see a broad spectrum across boards and even within boards, with some boards and some directors more drawn to the direct-leadership calling, others to more collaborative leadership, and still others to neither.

A distinctive feature of this emergent governance model is that one size does not fit all. Rather than trying to cram square pegs into round holes, directors and executives are crafting their own way forward. And the way they will do so in good times can be quite different from hard times. Running through it all, however, is the common thread of boards more forcefully leading, not just monitoring. We believe that this is an important and welcome development. Publicly traded companies, in our view, deserve no less.[27]

With directors increasingly at stage center—responsible for leading the enterprise along with monitoring management—they will want to begin with the central idea, the cornerstone for a company's mission and strategy. Chapter 2 takes up the central idea, what makes it compelling, and how its absence can cause a company to flounder. We will appreciate the former in a look at the power of a central idea at India's mobile phone operator Bharti Airtel, and we will see the latter in an American company whose board was pulled apart by the absence of a central idea.