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**WHAT MAKES CORPORATE BOARDS  
EFFECTIVE?**

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## **What Makes Corporate Boards Effective?**

In his recent book *The Mind of the CEO*, Jeffrey Garten concludes that most CEOs are today overwhelmed by a world of complexity that few can successfully manage: “Their considerable skills and determination notwithstanding, the pressures of this era will have proved much greater than anything these individuals could handle...today’s CEOs will be seen as captains of ships in turbulent seas – unable to chart a steady course and to maintain control of their own fate....”<sup>1</sup> If Garten is correct, then the likely success stories will be the CEOs who have surrounded themselves with a collective leadership talent that surpasses their own. This is true for talent at all levels of the organization, including an often-neglected source of strategic advice: the corporate board. While the board meetings of the past were more likely to be Japanese tea ceremonies, tomorrow’s are more likely to be war room planning sessions.

Several powerful forces are currently redefining the roles and activities of boardrooms, and they are not likely to diminish but rather to accelerate. Among the most potent of these forces are:

- An increase in the volume of corporate mergers and acquisitions and an accompanying need for careful due diligence that each of these deals places on boards, particularly the boards of the firm being acquired;
- The greater attention focused on corporate governance by institutional investors, who are growing less patient with under-performing companies;

- The larger role that corporations are playing in all aspects of today's increasingly global economy, which in turn is drawing greater attention by the national and international regulators concerned with the role of the firm in society;
- The accelerating pace and uncertainty of competition in the emerging networked global economy, where boards must respond more quickly to changing conditions and help firms forge a growing set of strategic alliances and partnerships.
- The accelerating turnover rate of CEOs that is placing enormous pressure on boards to be far more proactive in planning for succession.

In an attempt to address these challenges, boards have been experimenting with governance initiatives and new roles. You might even say it is the 'golden age' of board governance given the breadth of experiments aimed at empowering boards. Yet few have stopped to seriously examine what is working and what is not working. Even fewer have asked what their roles should be in an age of new competitors, new technologies, global business, more demanding customers, and overwhelmed CEOs.

### ***Today's Governance Initiatives: Are They Working?***

Over the last two decades, an enormous amount of effort has been spent exploring and devising new governance initiatives.<sup>2</sup> Most of these initiatives in the United States aim to create boards that are more responsive to shareholders. They do so by attempting to balance the tremendous power that has traditionally resided in the CEO's hands by increasing the power of boards. A number of the more promising ideas for empowering boards that have now become widespread practices among the largest U.S. firms include: formal board appraisals of the CEO, a greater proportion of outside directors, a broader profile of directors to be more representative of society, having regular executive sessions where only outside directors meet, increasing stock

ownership by directors, and written board governance guidelines. Table 1 shows how frequently some of these ideas are used in the *Fortune* 1000 companies (see Appendix for details on the survey and methods). Overall, there is little doubt that there have been significant changes in board composition and operation made over the last twenty years.

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**Insert Table 1**

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At the same time, it is not clear whether these initiatives have made boards more effective in the governance process and as a result enhanced the effectiveness of their organizations. In other words, it is not clear whether today's initiatives have indeed improved performance of the board as both a watchdog and a source of counsel to senior management. Certain of the most promising initiatives still remain largely proposed changes. For example board and individual director evaluations, non-executive chairs, lead directors, limits on a director's number of board memberships, and the presence of foreign nationals as board members have yet to become commonplace practices (Table 2). In addition, there has been limited research on whether the most popular of the governance "best practices" do indeed enhance board effectiveness. The purpose of this article is to help fill this void by reporting on the findings of our research over the last five years on how board policies and practices are related to more effective governance and firm performance.

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**Insert Table 2**

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We believe that boards can and often do add value and that good governance practices can indeed help a board's performance. Potentially the right board practices can enhance the watchdog function of a board and enable it to act more rapidly and effectively when opportunities and problems arise. They can provide constructive feedback and guidance to the CEO and to his or her senior management team. They can bring a network of contacts and sources of knowledge that can be of great value to the company.

The right board practices, however, may be a necessary but not a sufficient condition for having an effective board. They can, for example, be adopted for the wrong reasons. One CEO told us that he adopted these practices because investors were impressed by them, and he believed that by adopting them his company's stock price would be improved. We suspect that a number of CEOs share his viewpoint. We also feel that it is possible for a board to be effective without adopting all or most of the practices. A firm with a strong CEO who assembles an equally strong and independent set of individual directors may be able to operate for some time as an effective board. The adoption of the right set of practices only increases the probability that the right behavior will occur, while acting as an insurance policy to help preserve good governance when the leadership changes or a crisis occurs.

### ***Critical Board Roles***

What are the critical activities of the board? The answer to this question must be shaped by the multiple responsibilities of boards, as well as by practical issues concerning what they are actually capable of doing. Boards have legal responsibilities; they have responsibilities to shareholders, to communities, and of course to members of the organization. The dilemma is that all of these groups put pressure on boards to engage in somewhat different activities.

Given the divergent demands of stakeholders, boards face a fundamental problem in setting priorities. The issue is confounded by serious constraints on board members' time and influence. The average large company board met eight times per year in 1999, and much of this meeting time was devoted to reviewing company performance and administrative tasks.<sup>3</sup> While directors spend considerably more time outside of the formal meetings on board-related activities [an average of 159 hours in 1997, with high-tech company chairmen spending the most time (187 hours)], they still face hard choices about where to focus their efforts. Outside the boardroom, directors typically hold full-time jobs, and as such they are not able to spend more than a few hours a month on board activities beyond directors' meetings. Further, many directors are on more than one board - in some egregious cases, a half-dozen or more boards. Most directors of large corporations do not hold management positions within the company, thus the knowledge, information and power that they need to understand and intervene at the operating level of the company are simply not at their disposal.

Because of these characteristics of their members, boards face serious limits in their ability to meet all the potential demands placed upon them. They can realistically and effectively deal with only a small number of issues that face the corporation. As such, they must focus their energies on those responsibilities where they have the greatest leverage and where they are held most accountable. This leads to the natural question: Given the practical constraints on boards and their legal mandate, what should their principal responsibilities include?

Within the academic literature, there are widely diverse perspectives on the role of the boards. Agency theorists emphasize the board's primary role as monitoring the behavior and performance of executives.<sup>4</sup> Legal scholars focus on the roles that boards must satisfy to fulfill their legal responsibilities as overseers of the corporation, including representing the interests of

shareholders, selecting and replacing the CEO and guarding against any infringement of the law. Management experts, on the other hand, stress the crucial service role that board directors play in providing strategic advice to top management and in promoting the reputation of the company externally.<sup>5</sup> As an example, resource dependence theorists argue that boards, through their members' networks with other organizations, exist to help companies obtain key resources such as capital and business partnerships.<sup>6</sup>

Directors themselves have differing and sometimes ill-defined views of their proper roles on boards. For example, in our analysis of Korn/Ferry's recent survey of the board members of the *Fortune 1000* companies, outside directors were more than twice as likely as chairpersons and three times as likely as inside directors to attach maximum importance to "reviewing CEO performance." Surprisingly, inside directors placed more emphasis on "responsibility to shareholders" than outsiders, while outsider directors placed more importance on "duty to employees" than insiders.<sup>7</sup>

A survey of CEOs found that in addition to corporate performance, CEOs believe that the two most important issues that boards should address are strategic planning and CEO succession.<sup>8</sup> In our interviews, CEOs had clear but varied perspectives as to the primary roles of directors. For example, we found that most focused on only two or three key responsibilities that they felt were important – surprisingly not many more than that. For some, boards were foremost a resource for thinking through strategic moves. For other CEOs, the directors' role as coach was most important. For still others, succession planning was the primary role

The one theme that was consistent in our CEO interviews was the value placed on the directors' role as a sounding board, or as one CEO told us, "an incorruptible coach". A good

board essentially serves as the CEO's confidant. Nicely summarizing the point, a CEO explained:

*“When you get to be the CEO, you don't have very many people you can talk with. You can't sit around and speculate with your direct reports, particularly about things that impact them. So it is incredibly useful if you have directors you can trust and think are competent, with whom you can share ideas and with whom you can dialogue about important issues. So first and very importantly, I need directors with whom I can talk with about the strategic direction of the company or about personnel moves. The second thing is to have directors who are sufficiently knowledgeable about the company to raise red flags. I think this is very, very useful.”*

Beyond the viewpoints of academics, directors, and CEO's, we know from research on organizations that other factors can have an impact on directors' roles. For example, the stage of a company's development dictates which roles and responsibilities should receive the most attention. A growing, high tech start-up is far more likely to require the resource and service functions of the board than is a large, public corporation owned predominantly by institutional shareholders, where the legal and agency roles take precedence.<sup>9</sup>

Responsibilities as determined simply by time investment are revealed by the survey results presented in Table 3, which shows how directors report spending their time in board meetings. The most frequently discussed topics have to do with corporate strategy. The number one strategic issue is mergers and acquisitions, followed closely by formulating strategy, monitoring strategy implementation and identifying threats and opportunities. These data clearly suggest that the major focus of board discussions is on the strategic direction of the corporation and particular major decisions involving acquisitions and mergers.

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**Insert Table 3**

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***Board Roles and Company Performance***

The Korn/Ferry survey asked directors to assess the effectiveness of their boards on different key dimensions of corporate governance. Analysis of the pattern of their responses suggests that directors have an impact in two key areas: internally (e.g. shaping strategy, succession planning) and externally (e.g. building networks) focused activities.

Boards that score more highly on either of these dimensions of board effectiveness show generally superior company performance (see Table 4). These results are confirmed in our regression analysis which demonstrates a very strong relationship between more effective governance on the combination of these roles and subsequent firm financial performance.

**Insert Table 4**

For example, focusing on external relationships seems to have stronger impact on stock market performance than on ROI, while focusing on strategy has the opposite effect. These findings suggest that having directors spend their time building relationships with outside constituencies, such as investors, possible potential strategic partners, the community, and government is a potentially productive long-term strategy for the board with respect to meeting the needs of investors.

In contrast, for boards that want or need an improvement in operating results, it may be more useful to concentrate their efforts on governing the internal workings of the corporation and contributing to setting and monitoring strategy. These internally focused activities are related to higher company financial results. Paying careful attention to how the firm is performing against

its strategic objectives appears to be vital to ensure the firm meets its financial targets and satisfies investor expectations. But too much board focus solely on internal and short-term issues may fail to yield sustained improvements in stock market returns. Taken together, these results suggest it is vital for boards to get the balance right between their internal and external activities, adjusting their focus to fit the strategic needs and financial pressures on the firm.

### ***Attributes of High Performance Boards***

Having established that board effectiveness is related to corporate performance, we are now in a position to consider the characteristics that boards require in order to perform successfully. Research on organizational effectiveness and team performance suggests that there are four attributes that individuals and groups must have if they are to be effective.<sup>10</sup> These four attributes- *information, knowledge, power* and *rewards*-are critical to any individual or group in an organization being effectively involved in managing an organization.

Table 5 provides a definition of information, knowledge, power and rewards as they apply to board effectiveness. It also includes a definition of a fifth attribute, opportunity, which is not normally considered in the literature on organizational effectiveness and involvement. Clearly opportunity is critical to the effectiveness of any group or team simply because most groups must have enough time to achieve their tasks. Opportunity, by itself, is not normally a key differentiator between successful and unsuccessful activities. This attribute is included here because boards meet only occasionally and are staffed, as noted, by part-timers, who often have major other responsibilities. Thus, boards must operate in a way that effectively utilizes the limited time that board members have. They must have members who are willing to spend the time that is needed to create an effective board.

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### Insert Table 5

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To explore whether there is a relationship among these five attributes and board effectiveness, we analyzed data from the more than 1,150 directors of the companies who responded to the 1996 survey. This survey contained questions about board practices relating to each of the five attributes in our board effectiveness framework. We then analyzed whether boards that have adopted each of these practices are more effective than their peers who have not. We measured effectiveness in two ways: first, using directors' ratings of how effectively their board performs key roles, and second, testing whether objective data on company's financial and stock market performance was linked to different board attributes and practices.

#### ***Board Practices and Perceived Governance Effectiveness***

If a practice is really useful in building a more effective board, then the directors on those boards which have adopted it ought to perceive their boards to be operating more effectively. To see if this is the case, for each practice we divided the boards into two groups: those who make high use of a practice and those who do not, and then compared the directors' ratings of their boards' effectiveness on a composite board effectiveness rating index.

The results shown in Table 6 indicate that boards which score highly on key attributes in our board framework have much higher ratings for effective governance. Looking first at practices that effect power, those boards that formally evaluate the CEO, have written guidelines for corporate governance, and control the meeting agenda, rate their effectiveness significantly higher than those that do not.

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### Insert Table 6

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Those boards whose directors have greater relevant information appear to perform their roles far more effectively than boards which are less well informed. More effective boards “have a range of indicators for organizational effectiveness” and “benchmark the firm against top performers in comparable industries”. With respect to opportunity, boards whose directors feel they spend the “right amount of time on long-term strategy” and on “identifying potential risks to the company” have much higher effectiveness ratings.

Limiting the number of inside directors on the board, another important board power factor, also appears to lead to more effective governance. Our data shows that where 10% or fewer of the board members are inside directors, the boards are rated as more effective than boards with a higher percentage of insiders on both their internal strategic roles and on their success in building external relationships for their firms. Insuring that outside directors are at least in control of the board is important; the small percent of boards in large companies where insiders hold a majority of seats, rate their own effectiveness lower than the rest of boards.

Interestingly, the one area of board practices that shows little if any relationship to the perceived effectiveness of boards is how directors are paid. Shifting a higher percentage of director pay from cash to stock does not show any relationship to board member perceptions of effective governance. Likewise, those boards that require directors to own stock rate their board’s performance only slightly better than those that do not. Some argue that this is because most companies do not give their directors enough stock as a percentage of their overall net worth to create a significant incentive, while others contend that making all directors owners

makes it more difficult for them to exercise the independent judgment their governance role requires. A recent study shed some light on this issue, it found the board members in high performing companies owned five times more stock in their companies than did board members in low performing companies.

### ***Board Practices and Company Performance***

While a practice that has a positive impact on how well directors perceive their boards to be governing is important, the ultimate test of whether it is truly a “best practice” is whether or not it can be shown to have an impact on the company’s performance. Our results indicate that there is a clear payoff in firm performance both in current and future years from adopting many of the identified board practices (see Table 7).

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### **Insert Table 7**

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The impact of some practices is particularly impressive. Boards that had better information because they benchmarked their “firm against top performers...” had more than double the stock market return and 50% higher return on investment than those that did not one year later. Likewise, boards that spent the right time on strategy, have a broad range of indicators for organizational effectiveness, and have the power to balance the inherent advantages of the CEO (e.g. by controlling selection of new directors and key committees) oversaw companies that recorded much higher stock market returns than firms that scored lower on these practice.

Table 8 shows that there is a relationship between the number of outside board members and economic performance. Those companies with a large number of outside members clearly

outperform those with a small number. This reinforces the point that board power is a critical determinant of company performance.

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**Insert Table 8**

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Among the other board characteristics that our data show have an impact on financial performance are:

- Conducting a formal evaluation of the CEO
- Spending time identifying potential risks to the company
- Having the right technical expertise among board members

While it is useful to understand the impact of individual board practices on firm performance, it is just as vital is to understand how the combined elements of an empowered board effect governance and firm performance. To analyze this, we constructed a statistical model that examined the impact of *power, time, information, and motivation* together on effective governance and company financial results, when controlling for such factors as firm size, industry and capital intensity. We found that each element of our framework has a strong and independent statistical relationship with directors' perceptions of effective governance and that together they can explain nearly one quarter of the variation in board effectiveness.

The single board attribute that has the largest direct impact on firm financial performance is the power of the board relative to the CEO. We find that boards which conduct a formal, written evaluation of the CEO and where the outside directors have clear control over the nomination of new directors and the successor to the CEO have significantly better returns on assets, sales and investment than those that do not. This suggests that maintaining some degree

of formal independence between the board and chief executive is an indispensable prerequisite to creating an effective board.

The board of practices which are associated with effectiveness can be adopted by any board. There are no legal obstacles and the adoption of many of them is supported by major shareholder groups. Some of them do represent significant changes in the way some boards have operated, for example, doing a formal evaluation of the CEO. Thus, general adoption of some of them may be slow. Nevertheless, we believe that growing pressures on boards to be effective will result in widespread adoption of them just as it has already led to many of them being widely adopted.

### **Board Effectiveness**

Our study provides strong evidence that boards which adopt certain key practices are able to govern more effectively and produce superior company financial performance. Among the key lessons for boards are the vital need for directors to have the five attributes that are part of our performance effectiveness model.

Boards need information on a broad set of indicators of organizational effectiveness which also includes comparative data on how the leading competitors are performing in the firm's sector. The growth of the Web is making it much easier to deliver this and other performance information in a timely fashion. It would also be helpful to include comparative information on potential future competitors and new entrants.

The opportunity to devote time to the company's long-term strategy and to identify the potential risks to the firm is also critical to board effectiveness. Boards cannot use their time and information effectively if they lack the knowledge of the key technological and market changes affecting the firm's future. Special sessions devoted to strategy discussions along with on-going

presentations from experts on critical and emerging market trends should be an essential part of a board's agenda.

Boards need the power to counterbalance top management, which can be maintained by insuring that outsiders hold a clear majority of board positions, control the meeting agenda, and conduct a formal, annual evaluation of the CEO's performance. One other possibility is to have an outside source as board chair or to have a lead director who is an outsider.

Finally, boards need rewards that motivate directors to perform effectively. Stock ownership for outside directors is one possible way to accomplish this. Our data does not support the use of stock for directors, but recent research suggests that if outside directors have significant enough share holdings they will be motivated and maintain a continual focus on corporate performance.

The board practices which are associated with effectiveness can be adopted by any board. There are no legal obstacles and the adoption of many of them is supported by major shareholder groups. Some of them do represent significant changes in the way some boards have operated, for example, doing a journal evaluation of the CEO. Thus, general adoption of them may be slow. Nevertheless, we believe that external pressures on boards to dramatically enhance their effectiveness will result in their widespread adoption.

### **Conclusion: The Next Great Governance Challenge**

In the span of a few decades, the norm for US corporate boards has gone from being their relatively ineffectual "pawns" who could be easily manipulated by management to becoming strategic resources that can provide advice and exercise independent oversight to insure that firms stay focused on creating value. As the capabilities of many boards have increased,

however, the demands on boards have been growing at an even more rapid rate. It is important not to over-estimate what boards can achieve – they remain, by necessity, relatively removed from the running of a business. However, our analysis of high performance boards strongly suggests that it is both feasible and beneficial for boards to re-examine their roles and to continue to build their capabilities by adopting practices that support their developing information, power, knowledge, rewards and opportunity.

Ironically, as boards become more effective, it is increasingly important to question what we mean by an *effective board*. The vast majority of U.S. governance practices are concerned with enhancing board effectiveness with respect to *shareholder value*. Most boards equate the owners of the firm with those who control its equity. This perspective may be too narrow a mandate given the current business environment and the challenges companies are likely to face over the next century. Employees, suppliers, and communities are all increasingly “investors” in firm-specific assets. As a result, the definition of board ‘effectiveness’ needs to change from a narrow *shareholder* emphasis to a broader *stakeholder* one. Thus, its decisions and actions need to be judged on criteria that goes beyond financial performance to include their impact on human capital and communities.

The adoption of a stakeholder perspective is consistent with important trends that are unfolding in the global business environment especially those concerned with knowledge workers and supplier relationships. Already a few far-sighted companies have formally adopted this view. Magna International, a large Canadian manufacturing firm, has adopted a Corporate Constitution that “protects and promotes the interests of all its stakeholders” – specifying, for example, the percent of profits that will go to taxes and reinvestment (55%), shareholder dividends (20%), employee equity and profit-sharing (10%), management profit participation

(6%), R&D (7%), and social responsibility (2%).<sup>11</sup> While Magna adopted this innovative stakeholder constitution because the founding Stronach family believed it is right, the legal environment in the United States enables public corporations to adopt similar initiatives. Since 1985, at least twenty-seven states have enacted laws that allow directors to consider stakeholders beyond the company's shareholders in making a major business decision. Stakeholders, in this case, are defined as groups whose interests are tied to the company such as creditors, suppliers, employees, and the community.

Whether or not public companies in the United States will adopt a wider stakeholder perspective will be one of the most interesting and important issues in corporate governance over the coming decades. Adoption could lead to a number of changes in how boards and corporations operate. In the case of boards, it could lead to changes in the membership composition of boards so that they include representatives of the key stakeholder groups, instead of just owners, company executives, and individuals from the executive ranks of other firms. In the case of corporations it could lead to them adopting a more balanced scorecard approach to measuring their performance and to their being more concerned about the impact of corporate actions on employees, communities and suppliers.

## **The Appendix: Study Methodology**

The research presented in this article is based primarily on interviews conducted by the authors and on analysis of items that we included in the Korn/Ferry International Board of Directors Annual Survey. This survey has been sent to all of the directors of the publicly-traded Fortune 1,000 U.S. firms each year since 1973. The survey consists of 10 pages of questions (yes/no and 1-5 Likert scales) asking directors to report on the current governance practices and effectiveness of the largest publicly-traded board on which they serve.

Starting in 1996, we formed a partnership with Korn/Ferry to aid in the redesign and analysis of the survey to make it more appropriate for research purposes and to try answer the question: Are effective governance practices related to company performance? The analyses presented in the book are based on the 1996 survey to which more than 1,150 chief executives, inside and outside directors responded.

In order to investigate the relationship between board practices and company performance, directors were asked for the first time in 1996 to give the name of the company on which survey answers were based. This question was optional and directors from 354 companies responded. In cases where there were multiple respondents from the same company, one was chosen at random to represent that particular board.

Firm performance and market data for the 354 company responses was drawn from Standard and Poor's Compustat database and the CRSP databases for the 1996 and 1997. The Compustat data files are compiled by Standard and Poor's Compustat Services, Inc. from balance sheets, income statements, form 10Ks and other corporate financial reports. The CRSP data files were developed by the Center for Research in Security Prices (CRSP), Graduate School of Business, University of Chicago.

Return ratios were calculated as follows:

- Return on Investment (ROI) = earnings before taxes and interest/ (assets – current liabilities)
- Market Return =  $\exp [\sum \ln (\text{Monthly Stock Return}_{1-12} + 1)] - 1$

Two types of questions from the 24<sup>th</sup> Annual Board of Directors Study were used to measure board practices or perceived effectiveness. The first type was a simple “Yes” or “No” question about whether a certain practice was currently used: for example, “If your chairman is also the CEO, do you have a lead director among the outside directors?”

The second type of question asked directors to rate their boards on a scale from 1 to 5: e.g. does your board “has control over the meeting agenda?”, with respondents given a choice from “strongly disagree” to “strongly agree”. To determine whether a board scored high or low on a particular question, we compared its rating with the mean and standard deviation for all the companies in the sample. Companies were then categorized as “High” if the response was one or more standard deviation above the mean, and “Low” if the response was one or more standard deviation below the mean.

Factor analysis was conducted on nine questionnaire items regarding effectiveness in various board roles. The nine items separated cleanly into two factors which we categorized as “strategy formulation” effectiveness and “external networking” effectiveness. The strategy formulation scale contains six items with reliability of .81 and the external networking scale contains three items. In the 26<sup>th</sup> version of the study, conducted in 1998-99, surveys were sent to more than 7,000 directors of 902 publicly-traded Fortune 1,000 firms. More than 1,000 directors (215 CEOs, 187 inside directors, and 614 outside directors, responded, a 13% response rate. Data from this survey were analyzed to determine the degree to which partners are used.

In addition to the survey data from Korn/Ferry, as part of this study we conducted extensive interviews with over 100 CEO's, board directors, governance experts, and senior managers to learn in greater depth about governance issues and practices. Participants represented a broad sample of industries from natural resources to pharmaceuticals to high technology to finance to consumer goods. They ranged from mature to high growth industries and from well established to startups.

## **Acknowledgements**

The authors are deeply indebted to Korn/Ferry International for its support of our research on corporate boards. Korn/Ferry provided data from its annual survey of corporate boards as well as financial support for our writing, data gathering, and data analysis. We would also like to thank Beth Nielson for her invaluable support in collecting and analyzing this data.

For more details on the elements needed to support effective corporate governance see Conger, J., Lawler, E and Finegold, D. *Corporate Boards: New Strategies for Adding Value at the Top* (Jossey Bass, 2001).

**Table 1**

| Governance Practice  | Percent reporting this practice in 1999 |
|--|---|
| Outside directors meet in executive sessions without CEO present | 68.5%                                   |
| Formal process for evaluating CEO performance                    | 66.2                                    |
| Written guidelines on corporate governance                       | 65.3                                    |
| Directors required to own shares in the company                  | 63.9                                    |
| Annual retreat or special session to review corporate strategy   | 53.8                                    |

*Based on Korn/Ferry, 2000.*

**Table 2**

| Governance Practice   | Percent reporting this practice in 1999 |
|---|---|
| There are no term limits for directors  | 91.8%                                   |
| There are no limits on the number of board memberships on which the CEO and outside directors can serve | 78.0                                    |
| The entire board's performance is formally evaluated on a regular basis                                 | 37.4                                    |
| Have a foreign national on the board who lives and works overseas                                       | 25.3                                    |
| Individual director performance is evaluated on a regular basis   | 20.4                                    |
| Non-executive Chair who is not a present or former employee   | 2.9                                     |

*Based on Korn/Ferry, 2000.*

**Table 3**  
**Time Spent as Perceived by Board Directors**

|  | MEAN |
|--|------|
| Advising during major decisions such as mergers or acquisitions            | 3.8  |
| Shaping long term strategy   | 3.5  |
| Identifying possible threats or opportunities to the future of the company | 3.4  |
| Monitoring and evaluating strategy implementation                          | 3.4  |
| Evaluating and rewarding the performance of senior management              | 3.1  |
| Building external relationships that strengthen the company                | 2.8  |
| Planning for management succession   | 2.8  |
| Bolstering the company's image in the community                            | 2.4  |
| Responses 1 = Almost None to 5 = Most Time                                 |      |

*Based on Korn/Ferry, 1999*

**Table 4**  
**Board Roles and Performance**

| <b>Director Ratings of Board Effectiveness</b> | <b>Return on Investment (%)</b> |                          | <b>Stock Market Rate of Return (%)</b> |                          |
|--|---------------------------------|--------------------------|--|--------------------------|
|  | <b>High Effectiveness</b>       | <b>Low Effectiveness</b> | <b>High Effectiveness</b>              | <b>Low Effectiveness</b> |
| Strategy formulation                           | 19                              | 13                       | 31                                     | 32                       |
| External relations                             | 16                              | 14                       | 33                                     | 22                       |

### **Table 5 Key Attributes**

**Knowledge.** Knowledge refers to the expertise and understanding that is resonant in a group or individual. In the case of boards, of course, it involves expertise concerning areas such as business strategy, succession, finance, government, technology, society and how organizations operate.

**Information.** Information refers to data about occurrences, events and activities that affect the business. In the case of boards, it specifically means information about the operations and management of the organization as well as information about the business environment and the performance and activities of competitors.

**Power.** Power is the ability to make and influence decisions. In the case of boards, it means the power to reach decisions about the key issues facing a company as well as the ability to have it accepted and implemented by the members of the corporation.

**Rewards.** Rewards influence the willingness of individuals to commit their energy to perform a particular task. In the case of boards, rewards influence the motivation to attend meetings, read materials, spend time on corporate activities, and, of course, to make decisions that will contribute to organizational effectiveness.

**Opportunity/Time.** Opportunity refers to groups having the chance to actually make effective decisions and to perform effectively. It is a necessary precondition to the effective utilization of the knowledge, information, power and motivation that exists in a team or work group. In the case of boards, relevant issues include the frequency and timeliness of meetings, whether meetings are of sufficient duration for dealing with key issues, whether there is time to prepare for meetings and, the opportunity to discuss and vote on important decisions.

**Table 6**  
**Board Practices and Board Effectiveness**

|  | <b>Board Effectiveness<sup>2</sup></b> |                |
|--|--|----------------|
|  | <b>High Use</b>                        | <b>Low Use</b> |
| <b>Board Characteristics and Practices<sup>1</sup></b>   |  |                |
| Board spends time identifying potential risks to company   | 4.21                                   | 3.11           |
| Board spends time on long-term strategy  | 4.12                                   | 3.08           |
| Board has broad range of indicators for organizational effectiveness   | 4.03                                   | 3.09           |
| Board benchmarks the firm against top performers in comparable industries  | 4.01                                   | 3.05           |
| Board controls the meeting agenda  | 3.85                                   | 3.46           |
| Written guidelines on corporate governance   | 3.76                                   | 3.47           |
| Formal process for evaluating CEO performance  | 3.74                                   | 3.42           |
| <sup>1</sup> Based on ratings by board members   |  |                |
| <sup>2</sup> Effectiveness is a five point scale, 1 = Very ineffective, 5 = Very Effective, board member ratings |  |                |

**Table 7**  
**Board Practices and Stock Market Performance**

| <b>Board Characteristics and Practices</b> <sup>1</sup>              | <b>Return on Investment (%)</b> |                | <b>Stock Market Rate of Return (%)</b> |                |
|--|---------------------------------|----------------|--|----------------|
|  | <b>High Use</b>                 | <b>Low Use</b> | <b>High Use</b>                        | <b>Low Use</b> |
| Board spends time on long-term strategy                              | 20                              | 13             | 34                                     | 25             |
| Board has needed technical expertise                                 | 17                              | 14             | 38                                     | 26             |
| Board has power to balance CEO <sup>2</sup>                          | 21                              | 13             | 37                                     | 24             |
| Board has broad range of indicators for organizational effectiveness | 24                              | 15             | 37                                     | 26             |
| Board benchmarks firm against top performers                         | 23                              | 11             | 36                                     | 17             |
| Board spends time identifying risks to the company                   | 20                              | 11             | 43                                     | 22             |
| Board controls the meeting agenda                                    | 17                              | 14             | 32                                     | 31             |
| Board conducts a formal evaluation of the CEO <sup>3</sup>           | 17                              | 13             | 31                                     | 28             |

<sup>1</sup>Based on rating by board members 1996  
<sup>2</sup>Board power is measured by (1) who appoints committee chairs and members, (2) how the CEO is evaluated, and (3) the amount of influence the board has over CEO succession.  
<sup>3</sup>A Yes/No question

**Table 8**  
**Ratio of Inside to Outside Directors and Company Performance**

|   | Board Membership <sup>1</sup>               |  |  |
|---|---|--|--|
|   | Small<br>Number of<br>Insiders <sup>2</sup> | Medium<br>Number of<br>Insiders <sup>3</sup> | High<br>Number of<br>Insiders <sup>4</sup> |
| Return on Investment (%) 1996   | 18  | 16   | 13   |
| Return on Investment (%) 1997   | 21  | 16   | 15   |
| Stock market rate of return (%) 1996  | 35  | 22   | 27   |
| Stock market rate of return (%) 1997  | 43  | 30   | 30   |
| <sup>1</sup> Based on 1996<br><sup>2</sup> Less than 10% Insiders<br><sup>3</sup> Between 10% and 50% Insiders<br><sup>4</sup> More than 50% Insiders |   |  |  |

<sup>1</sup> Garten, J. 2001. *The Mind of the CEO*, Basic Books: New York, p. 277.

<sup>2</sup> Johnson, J. L., Daily, C. M., & Ellstrand, A. E. 1996. Boards of directors: A review and research agenda. *Journal of Management*, 22: 409-438.

<sup>3</sup> Korn/Ferry International, "27<sup>th</sup> Annual Board of Directors Study".

<sup>4</sup> Fredrickson, J. W., Hambrick, D. C., & Baumrin, S. 1988. A model of CEO dismissal. *Academy of Management Review*, 13: 255-270. Walsh, J.P. & Seward, J.K. 1990. On the efficiency of internal and external corporate control mechanisms. *Academy of Management Review*, 15: 421-458.

<sup>5</sup> Alderfer, C. P. 1986. The invisible director on corporate boards. *Harvard Business Review*, 64: 38-52; Zahra, S. A., & Pearce, J. A. 1989. Boards of directors and corporate financial performance: A review and integrative model. *Journal of Management*, 15: 291-334.

<sup>6</sup> Pfeffer, J. & Salancik, G.R. 1978. *The external control of organizations*. New York: Harper & Row.

<sup>7</sup> Korn/Ferry International, "27<sup>th</sup> Annual Board of Directors Study".

<sup>8</sup> National Association of Corporate Directors and the Center for Board Leadership. 2000. Washington, D.C.: National Association of Corporate Directors.

<sup>9</sup> Conger, J., Lawler, E. and Finegold, D. *Corporate Boards: New Strategies for Adding Value at the Top*, San Francisco, Jossey Bass, 2001, Chapter 9.

<sup>10</sup> Mohrman, S., Cohen, S., & Mohrman, M. A. 1995. *Teams and technology*. Boston: Harvard Business School Press.

<sup>11</sup> Magna International. *Fair Enterprise: The Pursuit of Economic Freedom*, 2001.