Center for
Effective
Organizations

WHO'S IN THE BOARDROOM AND DOES IT MATTER: THE IMPACT OF HAVING NON-DIRECTOR EXECUTIVES ATTEND BOARD MEETINGS

CEO PUBLICATION
G 05-15 (487)

EDWARD E. LAWLER

Center for Effective Organizations
University of Southern California
Marshall School of Business

DAVID FINEGOLD

Keck Graduate Institute

July 2005

Center for Effective Organizations - Marshall School of Business
University of Southern California - Los Angeles, CA 90089–0806
(213) 740-9814 FAX (213) 740-4354
http://www.marshall.usc.edu/ceo

Who's in the Boardroom and Does It Matter:
The Impact of Having Non-Director Executives Attend Board Meetings

Edward E. Lawler III and David Finegold

Executive Summary

The presence of corporate executives at board meetings used to be assured. They were typically on the board and had a chance to influence board decisions and help the board carry out its decisions. Now that boards are dominated by independent directors, there is no assurance that corporate executives will be at board meetings. This raises the question of whether it's a positive to have them present. The present study looks at the impact of having key senior executives attend board meetings even though they are not on the board. The results generally show that boards function better when the heads of HR and marketing, CIOs and business unit heads attend meetings. When one or more of these individuals attend board meetings, boards do a better job at performance management and generally are more effective in a variety of areas including long term strategy development, CEO succession, identifying threats and assuring ethical behavior. The presence of the CIO was most strongly linked to the effectiveness of the board.

Who's in the Boardroom and Does It Matter:
The Impact of Having Non-Director Executives Attend Board Meetings

Edward E. Lawler III and David Finegold

One of the major themes in the recent reforms of US corporate boards is the importance of increasing board independence by cutting back on the number of inside directors and tightening the requirements for what constitutes a truly "independent" outside director. Today, almost half of the Fortune 100 have only one inside director, the CEO. While reducing the number of directors who are employees and the number of directors who have some business or family affiliation with the company may give the appearance of good governance and curry favor with investors, it remains an unanswered question whether it will create more effective and informed boards.

Outsider directors bring an external perspective and diversity of experience that are much needed onto boards. They often are in a better position to represent the owners of the corporation and provide a potential check on abuses by management. They also may be in a better position to evaluate the CEO and say no to the CEO. Thus, it is easy to argue that having a substantial representation of outside board members is a good thing for large publicly traded corporations.

But there are also some potential costs associated with having a board that is composed almost exclusively of outsiders. Perhaps the major cost is the lack of knowledge that they have about the conditions that exist within the corporation on whose board they sit. Some boards make the effort to keep their independent directors informed about what is happening in the firm, including information the CEO may be reluctant to share, by encouraging or requiring directors to make regular visits to company operations and by providing employees with an anonymous

hot line to contact the board. However, despite these efforts, independent directors generally lack detailed knowledge about what is happening in the corporation. They simply do not have the time, nor are they positioned to observe the day-to-day operation of the company. This in turn may make it difficult for them to detect fraud and abuse, as well as to assess the advisability of pursuing certain corporate strategies and business ventures. Thus, a case can be made of employees providing boards with their insights about the condition of the company and what strategy it should pursue.

Outside board members may also lack the right mix of expertise to deal with all the issues that come before a board. Typically, boards are made up of somewhere around ten individuals, and those individuals, even if they are chosen to cover diverse skill areas, may not have expertise in areas like compensation, group process and the legal issues that come before a board. Thus, they often need expert input. One place to get expert input is from paid consultants who serve at the request of the board. This approach is becoming more and more common as boards attempt to assert their independence from management. But there is a second source of expertise that boards can and perhaps should use: executives in the firm.

Executives who are not directors often possess specialized expertise the board is lacking and of course they often have detailed information about what is happening within the corporation -- much more detailed information than is likely to be available to an outside board member. The challenge for boards is to find ways for them to communicate freely with directors and to utilize them and their information effectively.

Executives in the Boardroom

One approach to taking advantage of the expertise of internal executives who are not on the board is to have them attend board meetings. Their roles at meetings can vary all the way from

being a passive observer to making formal presentation to being an active participant in the overall discussion. Even if they are only observing, there still may be some important advantages to having them there. On the one hand, the directors will get to know them, and as a result, may feel free to call upon them for input about the company and about their area of expertise. In addition, executives can gain a greater understanding of what the board wants, how it operates, and how to prepare proposals and ideas for the board. In essence, it has the potential to improve the two-way communication between board members and executives in the corporation.

Another advantage to having non-board members present at board meetings concerns executive succession. Having non-directors in the boardroom, particularly if they are active participants, can give the board a chance to assess and learn about executive talent in the organization. This can be critical when it comes to planning for executive succession and assessing the ability of the organization to implement particular strategies and activities.

Who Attends

As part of an ongoing survey research program on U.S. boards that is done by USC's Center for Effective Organizations and Mercer Delta, we asked board members whether executives who are not on the board actually attend board meetings, and if so, how often. We received responses to the survey from 200 board members in Fortune 1000 corporations. As might be expected, the boards represented were dominated by outside directors. The mean number of outside directors on boards was 8.4, while the number of inside directors was 2.2. A major reason for the small number of inside directors is the new requirements by the major stock exchanges that boards have a majority of independent directors.

Table 1 presents the results concerning the degree to which non-directors attend board meetings. The results show that non-directors do attend many board meetings. The CFO and the chief counsel are virtually always at board meetings or on the board. The rest of the non-director executives are almost never on the board and vary in the degree to which they attend meetings. The most likely to attend are business unit heads. Presumably this is in order to have them report on how their business units are doing, as well as to offer input to the board with respect to future strategies and business results. An additional reason may be succession management.

TABLE 1. ATTEND BOARD MEETING

	BOARD MEETING ATTENDANCE					
EXECUTIVE	Never	Rarely	Some-times	Often	Always	On Board
Chief counsel	**1**	**3**	**4**	**7**	**85**	**3**
Business unit heads	**0**	**4**	**22**	**43**	**31**	**0**
Head of HR	**6**	**19**	**35**	**22**	**19**	**1**
CFO	**0**	**0**	**1**	**8**	**91**	**7**
CIO	**8**	**28**	**40**	**15**	**9**	**0**
Head of marketing	**10**	**29**	**37**	**15**	**9**	**0**
Other executives	**0**	**10**	**51**	**28**	**11**	**1**

Percentage Frequency

The three heads of staff functions that were asked about are reported as being sometimes present. The most likely to be present is the head of HR; the next most likely is the CIO; and least likely is the head of marketing. None of these individuals is likely to be on the board, although in a few instances the head of HR is on the board.

Are executive insiders more likely to attend board meetings when there is a smaller number of insiders actually on the board? Our results show low, mostly negative, correlations between the number of inside directors and the number of non-director executives who are invited to board meetings. Thus it appears there may be a slight tendency for boards to invite

insiders to meetings when they lack a significant insider presence on the board. In this respect, insiders may be a substitute for the presence of insiders on the actual board.

There is also a strong relationship among the degree to which the CFO, CIO and head of HR attend board meetings. If one attends, the others are very likely to attend as well. Apparently, boards tend to have a general policy or practice to either invite or not invite heads of major staff functions to participate in the board meeting.

While it is interesting to know who is attending board meetings, the most important issue is whether the presence of non-director executives has an impact on how boards operate. Table 2 presents the correlations between key board processes and the attendance of four types of senior executives. The items used in the survey were factor analyzed, and three factors emerged. The first had to do with the board monitoring the company's performance and activities in five areas. The second focuses on how effective the communications are between the board and the rest of the company. The last one is concerned with the degree to which the board acts independently of management and the CEO.

The relationships are not shown for the Chief Council and CFO, because they are essentially on the board or always in attendance. In addition to looking at the presence of individuals, we developed an index to captuure the overall frequency of attendance by non-executives at board meetings.

TABLE 2. BOARD PROCESSES AND ATTENDANCE

	BOARD MEETING ATTENDANCE				
PROCESSES[1]	**Business unit heads**	**Heads of HR**	**CIOs**	**Heads of Marketing**	**Index of non director board attendees**
Board monitors company overall	**.21****	**.34*****	**.40*****	**.30*****	**.40*****
To what extent does the Board measure the company's performance in the area of corporate social responsibility?	.13	.27***	.31***	.22**	.30***
To what extent does the Board track measures of the company's human capital?	.18**	.28***	.25***	.18*	.30***
To what extent does the Board monitor the company's culture?	.21**	.25***	.32***	.33***	.33***
To what extent does the Board help develop internal candidates for future senior management positions?	.12	.26***	.27***	.14*	.26***
To what extent does the board have independent information channels that provide useful information about company operations and management practices?	.13	.18*	.33***	.23***	.27***
Management-Board communications	**.16***	**.14***	**.31*****	**.14**	**.29*****
To what extent does the CEO keep the Board informed about significant matters affecting the company?	.09	.13	.27***	.10	.27***
To what extent is the Board kept informed of key risks facing the company?	.19**	.09	.23***	.14	.23***
To what extent does the Board work well with senior management?	.04	.03	.20**	.06	.13
To what extent does the Board receive sufficient information to carry out its responsibilities?	.16*	.18**	.23***	.09	.24***
To what extent do Board members and the CEO communicate between scheduled meetings?	.13	.12	.22***	.13	.22***
Board acts independently	**.19****	**.31*****	**.30*****	**.20****	**.39*****
To what extent does the Board influence the meeting agenda?	.16*	.22**	.22**	.15*	.32***
To what extent is the Board independent of management?	.12	.23***	.19**	.08	.23***
To what extent do Board members voice opinions that conflict with the CEO's view?	.15*	.15*	.16*	.14*	.21**
To what extent to Board members act with courage and take appropriate action as needed?	.14*	.17*	.19**	.04	.17*
To what extent does the Board have an effective process for selecting new members?	.13	.30***	.23***	.20**	.36***

Significance Level: * $p \leq 0.05$ ** $p \leq 0.01$ *** $p \leq 0.001$

[1]Response Scale: 1 = To a Very Small Extent or No Extent; 2 = To a Small Extent; 3 = To Some Extent; 4 = To a Great Extent; 5 = To A Very Great Extent

Board Communication and Monitoring Processes

The first behavior of interest has to do with boards monitoring the company's overall performance. As can be seen in Table 2, boards were able to do this to a greater extent when they had more outsiders present. The index of overall non-director attendance shows a particularly high correlation between monitoring and the attendance of non-directors. The presence of the CIO and head of HR were strongly correlated with boards being able to monitor the company's overall performance. The presence of the HR executive is also, not surprisingly, highly correlated with the board's ability to monitor the organization's human capital. The most obvious reason for these findings is that when they attend board meeting company executives provide board members with information they would not receive otherwise.

Communications

The results concerning the presence of executives at board meetings and communications between the management and board show positive relationships. The strongest relationship is between the presence of the CIO and the degree to which the board is informed by management and has sufficient information to carry out its responsibility. This may well be due to the fact that by being at the board meetings, CIOs are able to identify what information boards need and feel responsible for communicating it to them.

Board Independence

A potential objection to increasing the presence and participation of a company's top managers n the boardroom is that it will undermine board independence and further tilt the balance of power to insiders. However, the results in Table 2 show that the presence of more non-director

executives doesn't lead to a board being a captive of management. In fact, quite the opposite appears to be true.

The highest correlations involve the presence of the head of HR and the CIO. The more frequently they are present, the more the board feels it operates independently of management. In the case of the head of HR, the correlation is particularly strong with respect to the board having an effective process for selecting new members. Apparently, some of the knowledge that HR has about the selection process is being used to influence the board's selection process and to make it more effective. This is an interesting example of where technical knowledge of a non-board member executive can help the board be more effective.

Overall, the results concerning board processes clearly show that boards are more independent, have better information, and better communications with management when they have senior managers who are not on the board attend their meetings. The data showing that boards operate more independently when outsiders are present are particularly interesting. They suggest that getting information from executives and having them be present results in board members being more, rather than less independent, a finding that is contrary to the common belief that boards are likely to be less independent when insiders are present. One explanation for this is that the additional information they receive gives them a greater ability to reach their own conclusions and increases their confidence in their judgments.

Performance Management and Board Evaluations

To comply with the boards are increasingly doing performance reviews of themselves, individual directors, their committees, and the CEO. There are some reasons to believe that the presence of outsiders may make one or more of these evaluation processes more effective. The CIO, for example, has considerable data that are relevant to these evaluations. The HR head can help

facilitate the evalution process, providing expertise on how to conduct performance reviews, feedback methods, and data on how well the organization's human capital management is being managed. Thus, there is good reason to believe that their presence during board meetings might lead to better performance reviews.

One other factor warrants mentioning when it comes to performance reviews and the presence of insiders who are non-board members: in addition to providing data, they might to some degree act as motivators of good process and practice. Because the board members know that they are being "observed" when the review process takes place, they may well be motivated to do a better job.

Table 3 presents the results showing the relationship between how effectively the performance management system operates and the attendance of non-board members. Three of the evaluation processes do show significant relationships to the attendance of non-board members. The highest correlations involve CEO performance evaluations. The next highest involve the board evaluation of itself. The lowest significant correlations involve the committee evaluation process. Finally, the evaluation of individual directors shows generally insignificant correlations.

One explanation for the pattern of correlations concerning performance management is the degree to which the non-members have visibility with respect to performance and the evaluation process. In order for them to have an impact, they have to have visibility to what is going on. They probably have the greatest visibility of the CEO's performance and second-most visibility when it comes to the board's performance. They may not have visibility to the actual evaluation process for the CEO and board, but they certainly have visibility with respect to the performance of the CEO and the board. As a result, they have valid information to

contribute, and the board may be motivated to produce creditable evaluations because the executives have performance information. In contrast, non-board members are likely to have less to contribute to evaluations of committees and individual directors.

TABLE 3. PERFORMANCE MANAGEMENT AND ATTENDANCE

	BOARD MEETING ATTENDANCE				
PERFORMANCE MANAGEMENT[1]	**Business unit heads**	**Heads of HR**	**CIOs**	**Heads of Marketing**	**Index of non director board attendees**
How effective is the CEO performance evaluation process employed by the Board?	.15*	.25***	.26***	.27***	.29***
How effective is the Board evaluation process?	.15*	.18**	.27***	.20**	.25***
How effective is the Committee evaluation process?	.10	.13	.19**	.17*	.18*
How effective is the evaluation of individual Directors?	.03	.04	.21**	.12	.08
Effectiveness of the Board on assessing senior management's performance.	.07	.10	.23***	.18*	.18**

Significance Level: * $p \leq 0.05$ ** $p \leq 0.01$ *** $p \leq 0.001$

[1]Response Scale: 1 = Very Ineffective; 2 = Ineffective; 3 = Somewhat Effective; 4 = Effective; 5 = Very Effective

Regression analyses showed that the presence of the CIO contributed most to the effectiveness of the performance management activities of the board. This argues that at least part of the reason why non-member attendance correlates with performance management effectiveness involves information. By being present at board meetings, CIOs have the opportunity to present data to the board that are useful in evaluations. They also can better shape the data they gather to the kind of criteria that board members look at in evaluating the CEO, and perhaps to a lesser extent, the board itself.

Significant correlations involving the heads of HR suggest that they too can influence how effective the evaluation processes are. One way is by ensuring the process is a well-

orchestrated and defined one. Another way is by the data that they can gather and present that helps clarify judgments of CEO performance and board performance.

Overall, the results suggest that the performance management systems that boards are involved in operate more effectively when non-board members are in attendance at their meetings. The index of non-board member attendees shows the highest correlations. This strongly suggests that the more, the better when it comes to non-board member attendance at board meetings.

Board Effectiveness

Corporate boards are expected to be effective in a number of areas that influence corporate performance. In addition to playing a role in strategy, among other things, they are expected to deal with mergers and acquisitions, financial performance, and shape the ethical behavior of the organization. As shown in Table 4, there appears to be a strong association between greater presence of executives in the boardroom and how well the board performs these different roles.

The strongest correlations are with the shaping of long-term strategy. In this area, the attendance of all four types of non-board members is significantly related to effectiveness. In addition, the index of non-board attendees is related to effectiveness in shaping long-term strategy. In some respects, this is not surprising, since all of the senior executives in a corporation are likely to have potentially valuable inputs and ideas about what an organization's strategy should be and how it can effectively execute it. Exposing board members to these individuals and to their ideas makes a great deal of sense, and thus, the relationship with effectiveness of the strategy process is to be expected.

TABLE 4. BOARD EFFECTIVENESS AND ATTENDANCE

	BOARD MEETING ATTENDANCE				
BOARD EFFECTIVENESS[1]	**Business unit heads**	**Heads of HR**	**CIOs**	**Heads of Marketing**	**Index of non director board attendees**
Board shaping long-term strategy.	.21**	.20**	.27***	.24***	.30***
Board planning for CEO succession.	.12	.14*	.19**	.14*	.22**
Board balancing interests of different stakeholders.	.18**	.16*	.14*	.16*	.21**
Board identifying possible threats or opportunities critical to the future of the company.	.12	.03	.17*	.18*	.15*
Board advising during major decisions such as mergers or acquisitions.	.06	.11	.17*	.08	.16*
Board monitoring the firm's financial performance.	.00	.03	.12	.08	.05
Board ensuring ethical behavior within the company.	.17*	.10	.24***	.24***	.22***
Board overall effectiveness.	.11	.09	.26***	.12	.22**

Significance Level: * $p \leq 0.05$ ** $p \leq 0.01$ *** $p \leq 0.001$

[1]Response Scale: 1 = Very Ineffective; 2 = Ineffective; 3 = Somewhat Effective; 4 = Effective; 5 = Very Effective

Attendance of non-board members is also related to planning for CEO succession. There are a number of explanations for this, but perhaps the most obvious one is that the attendance of senior executives at board meetings gives the board information about the talent available in the organization and can very directly facilitate its planning for CEO succession. It is most likely that boards recognize this and as part of their succession work invite non-board members to attend their meeting. Attendance at board meetings can also help internal CEO candidates learn about how boards operate and help them develop a comfort level in dealing with boards.

One area where attendance is not related to non-board member attendance is monitoring financial performance. This follows from the point that the CFO is either on the board or in attendance at virtually all board meetings. The CFO is clearly the key member of senior management when it comes to monitoring financial performance and since the CFO is present, the presence or absence of other members of senior management is not critical to monitoring financial performance.

The relationship between ethical behavior and attendance is interesting. In general, having non-director executives attend meetings is associated with greater perceived board effectiveness at "ensuring ethical behavior within the company." Attendance by non-director executives gives boards the opportunity to both sense the ethical climate of the organization and communicate to senior managers how important ethical behavior is it is an expected result. Surprisingly, the one type of executive whose presence is not associated with the capacity to monitor ethical behavior is the head of HR, the function nominally in charge of the people within the firm. It is not clear why this relationship doesn't exist, but we conjecture that it may be that given their role HR executives are hesitant to raise these issues.

Overall, the results concerning board effectiveness are consistent with and follow directly from the results concerning communication, independence and performance reviews. They all suggest that having non-board member executives present during board meetings is an important way to enhance board performance.

Conclusion

We know of no historical data that track the presence of non-directors at corporate board meetings. Thus, it is impossible to state whether this practice has increased or decreased. Our belief, however, is that it has increased significantly in response to the recent changes in

corporate governance. In the past, a significant number of the key executives in companies were on the board, so they were in the position to carry out the decisions of boards and to provide boards with information. Now that fewer executives are on U.S. company boards, a substitute needs to be found for them. The answer is a relatively simple one to implement; it is to have key members of management who are not on the board be present at board meetings.

Our research suggests that there is one executive whose presence is most strongly and consistently related to the effectiveness of the way the board operates and its overall effectiveness: the CIO. One possible explanation for this is the knowledge and information that the CIO can provide to the board in an increasingly web-based economy. The more the CIO can present the kind of information the board wants in a timely manner, the more likely the board is able to deal with its many difficult challenges and issues. The CIO's presence also has the potential to help the CIO know the kinds of issues the board is interested in and thus to develop information that will support good decision making on the part of the board. Overall, it seems clear that CIOs should be in attendance at most board meetings.

A strong case can also be made for the head of HR being present at most board meetings. This position has the second-highest correlation with the effectiveness of the board's processes and with communication between management and the board. It is surprising that it does not have a significant correlation with the overall effectiveness of the board, but it does correlate with several areas of board effectiveness. An effective HR executive can bring multiple perspectives to the board, for example, how well the board operates and how the organization treats it employees. An effective head of HR also can provide data about the human capital of the organization and organizational effectiveness that is relevant to strategy as well as to the

performance management processes of the board. Thus, the chief human resources executive, in most cases, should be in attendance at board meetings.

The weakest cases for attendance involve the business unit heads and the head of marketing. These cases, however, are not so weak that the conclusion should be reached that they should not be in attendance at board meetings. They clearly contribute to a number of positive features of board meetings, and therefore, it is possible to justify their being in attendance at board meetings as well. This is particularly true since the data overall strongly suggest that the more non-board members who are present at board meetings, the more effectively the board is likely to operate.

Our results also suggest some key times during board meetings when it may be particularly important to have non-director executives in the boardroom. One time when executives should be present is during discussions around long-term strategy and ethical behavior. Our results show that they can help shape strategy and are critical to the implementation of it. Much the same thing can be said when it comes to ethical behavior. Without the support of senior management for ethical standards, they stand no chance of being meaningful. Thus it makes sense to have them involved in the formation and the discussion of the company's ethical standards.

Having non-board members present at meetings is certainly not a cure-all for the ills of corporate boards, but our data suggest that it is one piece of the puzzle that needs to be in place for boards to be effective. When it comes to many decisions that boards make, transparency and implementation are the key issues. Having non-board member executives present is a way to help achieve both these goals.

The data also suggest that the fear that having non-board member executives present will lead to boards dominated by insiders appears largely unfounded. Avoiding insider-domination most likely is a matter of carefully structuring the role of non-board member executives who attend the meetings so that they do not create an insider-dominated mentality on the board, even though the majority of the votes are in the hands of outsiders. There are a number of processes that can be used to see that this does not happen. Among them are the presence of an independent outside chair or lead director, and scheduling regular sessions that are open only to outside directors. These practices are becoming increasingly popular, 75 percent of the companies in our sample report having a lead director and 95 percent report having regular outside director meetings.

What does the future hold? We think it should involve a critical role for senior executives who are not on the board. The advantages are many, and the drawbacks are relatively few. Now that boards are so heavily dominated by outsiders, without top management team members present, there may be no one to speak for the inside, except for the CEO. There are obvious problems with the CEO trying to both represent and depict what things are like in the organization and be the only one to carry the message from the board to the rest of the company. A shared leadership model is needed in which individuals who are not on the board help lead the organization in the right, strategic direction. Having the ability to do this is much greater if the leaders of an organization attend board meetings. The conclusion, therefore, is that multiple non-board member executives should attend most corporate board meetings.

Selected Bibliography

Our earlier research on boards can be found in Conger, J. A., Lawler, E. E., and Finegold, D. (2001). Corporate boards: New strategies for adding value at the top. San Francisco: Jossey-Bass. A new book by Nadler, Behr and Nadler, Building Better Boards: A Blueprint for Excellence in Governance, Jossey-Bass, 2005, reports of many of the changes in boards that have resulted from recent reform efforts. Other useful materials on boards can be found in Lorsch, J.W., and Nadler, D.A. *Report of the NACD Blue Ribbon Commission on Board Leadership*. Washington, D.C.: National Association of Corporate Directors, 2004; Conger, J.A., Lawler, E.E., and Finegold, D.L. "Holding Leadership Accountable." *Organizational Dynamics*, Summer, 1998; Charan, R. Boards at Work. San Francisco: Jossey-Bass, Calif. 1998; and Conger, J. A., Finegold, D. and Lawler, E. E. (1998), Appraising boardroom performance, Harvard Business Review, 76(1), 136-148.