Building a Board That's Independent and Effective [WSJ, Nov 19, 2002 by Carol Hymowitz]

{*note: emphasis added by RD in italics* }

The days when chief executives filled their boardrooms with cronies are over. In the wake of this year's business scandals and subsequent crop of new corporate governance proposals, CEOs are scrambling to remove directors who are business clients or have other conflicts of interest and to recruit fresh board members willing to speak their own minds.

At **General Electric**, chairman and chief executive Jeffrey R. Immelt implemented new board policies earlier this month that go beyond the requirements of the Sarbanes-Oxley legislation. Two-thirds of GE's board will be made up of independent outsiders by early next year, and required to be more involved in the company. They must visit two company sites each year and limit the number of other boards on which they serve.

But rules alone won't create strong and autonomous boards. *"Independence is a psychological condition as well as a legal one, so you can have directors who are technically independent but don't act that way when they become connected to a board," says Jay Lorsch, a Harvard Business School professor who advises companies on corporate governance.*

What counts most is whether directors feel free to tackle a range of issues affecting their companies, from succession planning to executive compensation. "We'll be fighting the wrong war if we simply tighten the rules for boards and ignore their more pressing need to be strong work groups whose members trust one another and aren't afraid to challenge senior management," says Jeffrey Sonnenfeld, associate dean of the Yale School of Management. He notes that directors at many companies touched by scandals, including **Tyco** and WorldCom, followed most of the accepted standards for boards, such as showing up regularly for meetings and establishing codes of ethics. They failed, however, to question enough and to think of dissent as an obligation -- qualities that directors at the highest-performing companies routinely exhibit, Mr. Sonnenfeld adds.

CEOs can promote candor by sharing just the right amount of important data with directors before meetings, so they have time to digest the issues and thoughtfully discuss them. Board chairmen should: rotate directors through committees, introduce the board to key company personnel and encourage every director to give opinions.

Sometimes even a lone dissenter on a board can exert a big influence. Bill George, former CEO and chairman of the board of **Medtronic**, a Minneapolis medical-device maker, says during his tenure, 11 of 12 directors approved a proposed $2.5 billion acquisition of Alza, a maker of drug-delivery systems. The single opponent, an executive at a pharmaceutical company, telephoned Mr. George after the meeting to argue that the acquisition would take Medtronic into an area it knew nothing about and divert attention from core medical products. He was so convincing that Mr. George reconvened the board on a telephone conference call to discuss the plan again. After hearing the dissenter out, other directors agreed that his analysis was cogent, and decided against the acquisition. "We could afford the deal but realized it would take us off course," says Mr. George. "Later, I told [the dissenting director] how much I admired his courage and willingness to stand against the board."

To encourage a frank exchange of views, Mr. George, who also serves as a director of **Target** and **Novartis**, thinks independent directors should meet separately from company insiders on the board several times a year, then report to the entire board. Boards that combine the jobs of CEO and chairman should elect an independent lead director, he says. In addition, Mr. George advocates board retreats for several days every year so directors have time to discuss issues in depth. "When you only have four hours at a board meeting, you can't get into any one topic too deeply," he says.

Directors also must regularly assess each other's performance and keep improving their governance duties. Only about one-fifth of 209 Fortune 1000 companies recently surveyed by executive recruiters **Korn/Ferry International** regularly evaluated individual directors, and only half of the directors on these boards thought the evaluations were worthwhile.Walter Salmon, a Harvard Business School professor who has been a director at such companies as Quaker Oats, **Neiman Marcus** and Hannaford, now a unit of supermarket operator **Delhaize America**, says one person can't do it alone. "It takes a nucleus of several strong directors to implement an effective review process," he says.

At Hannaford, directors were reviewed by outside board members each time they were nominated for re-election -- and sometimes encouraged to step down. He says directors must avoid getting stuck in prescribed roles, such as "accounting expert," and pool their expertise.

It takes time to build a good board, Mr. Salmon says. "Sometimes a trauma at a company can trigger a board transformation, but good governance usually isn't a case of immaculate conception," he says.