Best Practices

The Keys to an Effective Board

By Joseph Tarantino

High-performing boards focus on building long-term, sustainable growth in enterprise value and preserving the reputation and brand image of the organizations they govern. I personally see eight leading practices common to this upper echelon of boards.

1. Appoint a strong leader. The board chair builds a team that functions effectively and sets the tone for strong corporate governance. If the chair is not independent, an independent lead director plays this role. Working closely with the CEO and collaborating with the nominating and governance committee, the chair establishes appropriate procedures and criteria for selecting directors with the requisite experience, diverse perspectives, skills, and interpersonal qualities that facilitate an effective board. A strong chair keeps an eye toward the future, focuses agendas on the important topics, communicates well with key stakeholders, and reviews board effectiveness periodically.

2. Build a great management team and position it to succeed. Exceptional corporate governance begins with an effective process for recruiting, developing, empowering, evaluating, rewarding, and—when necessary—removing the CEO. Likewise, the board approves appointments of competent, qualified executive officers, as recommended by the CEO. An effective board ensures there is sufficient executive bench strength and an orderly succession plan for the CEO and key executive positions.

3. Set the right tone at the top. The board charges management with the responsibility to create a culture of performance with integrity, transparency, and commitment to ethical values and responsible business behavior. Enforcing a code of conduct that binds directors, executive officers, employees, upstream suppliers, and downstream channel partners is a starting point. The board should ensure there are practices in place to identify, assess, and resolve conflicts of interest.

4. Create a culture of trust and respect. For the board to function as an effective team, there must be a working environment of mutual respect that fosters candid and constructive dialogue. This is critical because there may be times when the CEO and the executive team can benefit from a challenging, robust debate.

5. Understand the key strategic drivers and risks. Understanding the key drivers of the organization's strategy best positions the board to be useful to the CEO. The board should understand the critical assumptions and risks underlying that strategy, and ensure that management has processes in place to continuously monitor the validity of those assumptions and manage the associated risks.

6. Link rewards to performance. Effective remuneration systems measure what matters in rewarding exceptional performance with exceptional pay and providing for meaningful downside for poor results. The compensation committee—with at least three independent directors—oversees the reward system and makes recommendations to the full board. The compensation structure should be simple, transparent, and targeted on sustained value creation while balancing the tension between providing short-term rewards for executives and preserving the interests of stakeholders over the long term. The committee should have authority to retain consultants and advisors as necessary.

7. Organize for effective engagement and oversight. The board should allocate responsibilities to various standing committees and delineate committee responsibilities (and that of the full board) to ensure more efficient and effective oversight. A simple majority of independent directors is only a starting point. A strong independent majority relative to insiders is the optimum composition of an effective board, with non-independent directors present as necessary to provide an appropriate range and mix of expertise, diversity, and knowledge.

8. Engage with shareholders effectively. With respect to shareholder communications, the board should provide effective oversight to ensure there is consistency, clarity, and candor, as well as reliable reporting of company performance on a timely and regular basis. With respect to communications from shareholders, the board should have procedures designed to encourage such communications in a manner consistent with securities laws. Shareholders also should have an opportunity to approve specified transactions, e.g., in conjunction with the annual general shareholders' meetings.

Everyone has a list. The above is only mine, and I make no claim that it includes everything that drives board effectiveness. That said, I believe the above practices are fundamental to a successful board. The board needs to align its activities with the rhythm of how the business is run and managed to ensure that value is contributed in addressing the right topics and issues at the appropriate time.

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