



Counsel for  
BOARD AND EXECUTIVES

# Acredula®



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**A**credula is the Latin word for "owl," connoting wisdom. This newsletter is intended as wise counsel for boards and executives. Acredula is available to clients and friends of the firm. It is not to be construed as legal advice or opinion.

## Making Your Board More Effective

Last month's editor's note, "Caveat Director," was our most read editor's note, and the lead article "Questions to ask before joining a non-profit board" was the most read in the first 7 days after its republication on the Lexology and Association of Corporate Council Newsstand.

This month's issue continues that theme with, after joining a board, how you can make it more effective. Our lead article, "Ten Strategies to Make your Board More Effective" is a compilation of articles and presentations given by our Counsel for Boards and Executives, Faith Williams, Kevin Kinross and me, for boards and committees that are clients as well as for the National Association of Mutual Insurance Companies, Property Casualty Insurers Association, American Council of Life Insurers, Ohio Association of Nonprofit Organizations, Ohio State Bar Association CLE, Capital University School of Law, and others.

The first strategy in making a board more effective is for it to participate in determining "agreed" core fundamentals and "agreed" strategic direction. This is the foremost responsibility of a board. This month's second article, "Time to Involve the Board in the Strategic Process" by Kevin Kinross, focuses on the that responsibility, determining strategic direction.



### EDITOR'S NOTE

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The American corporate system had been viewed as outperforming the reset of the world in the 1980s and 1990s by being responsive to changing markets with quick decisions by strong CEO management that were overseen by independent directors. However, this structure is currently perceived as ineffective in determining long-term strategic direction, anticipating improbable but high impact events, providing stewardship for the future, and curbing the perceived greed of management. All of us as board members can probably do more to make our boards more effective.

## Ten Strategies to Make Your Board More Effective

Congress, regulators, prosecutors, investors, institutions and the media widely blame boards of directors for the financial crisis with headlines such as CNN's "Blame boards of directors for financial mess – Lack of care led to the financial collapse" and The Corporate Board's "Indepen-

dent boards, but ineffective directors." The American corporate system had been viewed as outperforming the rest of the world in the 1980s and 1990s by being responsive to changing markets with quick decisions by strong CEO management that were overseen by

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independent directors. However, this structure is currently perceived as ineffective in determining long-term strategic direction, anticipating improbable but high-impact events, providing stewardship for the future, and curbing the perceived greed of management.

Whether or not this perception is reality, boards can do more to be effective. Below are 10 strategies for boards to consider to become more effective.

**Participate in determining “agreed” core fundamentals and “agreed” strategic direction.**

The foremost responsibility of a board is providing direction. At a minimum, the board should approve or ratify the organization’s strategic direction. A better practice is for the board to participate with management in first determining “agreed” core fundamentals and then “agreed” strategic direction. “Agreed” means arriving at a mutual understanding by the board and management as equal participants. So that focus of the organization will from the top down be on serving its stakeholders, being compliant with legal and ethical standards, and having a long-term view, core principals should include:

- Mission or “why we exist,”
- Values or “what we believe in and how we behave,” and
- Vision or “what we want to be in the next three to five years.”
- Strategic direction includes:
- Strategies or “what our game plan is to become what we want to be” and
- Scorecard or “how we monitor the implementation of the strategies.”

Having agreed core fundamentals and agreed strategic direction is necessary to attract and recruit the right people for the composition of the board as well as of management, which are among the foremost of board responsibilities.

**Act as stewards for the future.** All of the recent talk about “assessing and managing risks” is not helpful for board governance. A better approach is to remind directors that they are “stewards” for the future. Directors should assure that someone has considered the possibility of Nassim Nicholas Taleb’s “Black Swan” or occurrence of the improbable<sup>1</sup> by asking “how do we assure our ability to pay our bills as they become due if the action we take is a total failure?” Asking this question protects the solvency of the organization which is one of

the foremost responsibilities of stewardship. In protecting solvency, boards should consider directing some officer or group of officers to assess and apprise the board the solvency risks involved with each action requested of the board. The officer may be a standalone chief risk officer or a combination of existing officers such as general counsel and the chief financial officer.

**Align compensation and other incentives with measured achievement of agreed strategic direction subject to observing core fundamentals and being stewards for the future.**

Boards should assure that pay is consistent with pay-for-performance standards by overseeing the development of metrics to measure achievement of the agreed strategic direction over performance periods of two or more years. This should be done by using a balance scorecard<sup>2</sup> taking into account observing core fundamentals and being stewards for the future. Boards should keep in mind the observation of Steven Davis, CEO of Bob Evans, that “The first rule of executive compensation is that shareholders get paid first.” See the Editor’s Note, “Shareholders get paid first,” in the [September 2009 issue of Acredula](#). Boards should assure that the organization has the legal right to cause a complete forfeiture of unpaid compensation, and clawback of paid compensation, for failures in observing core fundamentals or being stewards for the future.

**Retain appropriate expertise on, or otherwise to be available to, the board.**

Boards should evaluate and inventory the individual skills, experience and other expertise of each of its members; determine the expertise needed in the foreseeable future; and then determine whether to fill any gaps in such expertise through:

- Recruitment of new or additional directors;
- Education of directors to enhance expertise; or
- Availability of advice of advisers to provide missing expertise.

Pursuant to the duty of care,<sup>3</sup> each director believing he or she does not have sufficient expertise should act as an ordinarily prudent person in like capacity under similar circumstances to obtain expertise reasonably necessary for consideration of any matter coming before the board. Traditionally, missing expertise has been provided through advisers retained by or for the board. In the future,

a more prudent practice for having expertise for recurring matters is recruiting new or additional directors with that expertise.

**Assure board members are committed in terms of time and freedom of conflicts.** Boards should review the willingness and ability of each director in terms of time and freedom of conflicts to act for the best interests of the organization. This includes periodic evaluations of each director’s outside interests, including other directorships, conflicts with a director’s time or the director’s

duty to act in the organization’s best interests. Boards should consider providing that the organization has the legal right to cause a complete forfeiture of unpaid directors fees, and clawback of paid directors fees, for failures to attend, without valid excuse, a minimum number or percentage of board proceedings. Generally smaller boards of nine or fewer members provide the most consistent commitment.

**Prepare the board to lead in a crisis.** Boards should prepare themselves to lead in a crisis, especially when management may be available. At least one outside director, such as a lead

outside director, should regularly participate in preparing the agenda for meetings and approving information being provided to directors. Outside directors should assure their ability under applicable governing documents to call and preside at meetings, including executive sessions where appropriate. Boards should have strategies for providing succession.

**Take reasonable precautions against liability.** Boards should assure that members of the board and management are periodically reminded of what precautions to take to reduce risks of liability, including what to do upon becoming aware of any claim or potential claim. Indemnification provisions should be reviewed periodically with the extent that indemnification is currently permitted by law. D&O coverage should be reviewed for its adequacy in the event of insolvency, bankruptcy and government funding as well as to the solvency of the D&O insurers.

**Protect the organization’s other resources, including reputation, from bargain hunters.**

Boards should consider adoption of strategies to prevent bargain hunters from taking advantage of low evaluations or under-performance to force divestures, distributions, or liquidation or changes in control. Boards also should consider adoption of strategies to reduce the risk of competition or head hunters in soliciting employees, customers, suppliers and other resources. Finally, boards and management should consider business decisions in light of damages to reputation if the decision results in a headline in the news or financial media.

**Assure necessary or required information is being provided and it is accurate and complete.** Boards should assure that there are periodic evaluations of whether all necessary information is being provided to the board and management and whether it is accurate and complete; and whether all required information is being provided to other stakeholders and whether it is accurate and complete; and whether there are safeguards to provide corrected information when information provided becomes materially misleading, whether because of adverse events or otherwise. This is generally accomplished by agreeing with management for materials to be furnished to directors three or more days in advance of meetings and separately questioning members of management regarding the information contained in those materials and comparing the consistency of their answers. Inconsistent answers is a sign of false or misleading information.

**Require continuous review and reporting to the board of operations and practices for compliance and improvement.** Boards should require management at least quarterly to provide a scorecard on progress made in implementing agreed strategic direction. Boards should regularly receive direct reports from general counsel and compliance officers on legal and ethical compliance and control of material risks. At least annually, boards should review the alignment of compensation incentives with achievement of the organizations strategic direction consistent with its core fundamentals and stewardship for the future. At least annually, boards should review the commitment of its members in terms of participation in proceedings and freedom from conflicts. At least annually, boards should review with management the timing and sufficiency of information directors are receiving

Boards should assure that members of the board and management are periodically reminded of what precautions to take to reduce risks of liability, including what to do upon becoming aware of any claim or potential claim.

Corporate America can best overcome the lack of confidence by Congress, regulators, prosecutors, investors, institutions and even the media by taking steps to become more effective. Focusing on the correct fundamentals; participating in determining agreed strategic direction; managing risks, providing stewardship for the future; aligning compensation and other incentives with pay with those fundamentals, strategic direction and stewardship; making expertise present on or available to boards; and pursuing the other strategies discussed in this article will strengthen corporate America.

**Footnotes**

<sup>1</sup> The central theme Nassim Nicholas Taleb's "The Black Swan. The Impact of the Highly Improbable." (2007) is that policy makers, such as boards, should focus on considering all of the possibilities, especially those that could have a high impact, albeit remotely probable, and not just the normal.

<sup>2</sup> A balanced scorecard multiple perspective performance evaluation first advocated by authors Robert Kaplan and David Norton to balance measures of a financial perspective with those of non-financial perspectives. The non-financial measures typically include measures of improvement in customer relations, learning and growth, and internal operating processes. It is commonly used as the performance measures for long-term incentive plans.

<sup>3</sup> The duty of care requires each director on an individual basis with the care that an ordinarily prudent person in a like position would use under similar circumstances.

# Time to Involve the Board in the Strategic Process



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As we close the book on another year, corporations are faced with continued unanticipated challenges and issues. While hope remains that the economy is on the mend, the business climate has again taught everyone that the only constant is change. Last year at this time, not many anticipated the full impact of the subprime crisis and resulting credit crunch that welcomed in 2009. As such, unforeseen events implicated the execution of many corporation's strategic plans. This past year was a painful reminder that strategic plans need to be living documents and that strategic planning has to be a task that provides structure going forward but that is flexible and can easily adapt to changes in the business environment. Now more than ever, the board of directors needs to play an active role in the strategic process as it is the body charged with providing direction and oversight to the corporation.

Depending on the size of the organization, management may bear the burden of getting the board involved in the process. Involving boards jointly with management in determining strategic direction generally results in stronger bonds between both groups.

Boards should play an integral role in all levels of the strategic process including thinking, planning and oversight of the execution of the strategic plan.

## Strategic Thinking

The strategic thinking process involves collecting and analyzing the current status of your industry, competitors and the position of the corporation. Boards should collaborate early with management in this process and provide an outsiders' perspective and expertise to test management's thoughts.

## Strategic Planning

The Strategic Planning Process takes the strategic thoughts developed by the board and management and develops priorities, actions and objectives for the core components of the strategic plan. Boards need to understand the core components of the plan and the potential legal, financial, reputation and operational risks to the organization that the plan may create. Boards need to provide additional considerations, question management and, when comfortable, approve the plan.

## Strategic Execution

Boards can fulfill their role of oversight to the organization by reviewing the process and progress of implementation of key initiatives and core components of the strategic plan by management as compared to established benchmarks and objectives.

Here are some steps to consider in involving boards in strategic direction that also includes determining competencies needed in the future:

- Explain to the board the need to be constructively involved in determining strategic direction. The goal is to build long-term stockholder value for the benefit of all stakeholders.
- Urge the board to do this as a whole rather than through a committee. Determining direction requires the view of every perspective available to the company.
- Clarify that the process is a joint role of both the board and management. Both should participate jointly in establishing the process as well as determining the direction.
- Agree upon the elements that are going to be considered in the process. One of the key considerations is the background, experience and expertise needed among management and the board to achieve the strategic direction.
- Direct management to propose strategies for discussion. The board's function is to discuss and question management's proposals, requiring

management, where appropriate, to reformulate strategy consistent with guidelines instructed by the board.

- Schedule, as one of the later considerations, the background, experience and expertise needed among management and the board to achieve the strategy.
- Require the board and management to jointly map out the changes or additions necessary to management and the board to acquire the needed background, experience and expertise.

Involving boards jointly with management in determining strategic thinking, planning and direction generally results in stronger bonds between both groups and provides a structure for a strategic plan to easily adapt when unforeseen circumstances, like those of the past year, make changes necessary.

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