The heart of the matter

Good governance depends on good relationships between the management and the board. Sounds simple and straightforward? It's not.

By Diana McLain Smith

In its 2004 *Principles of Corporate Governance*, the international Organization for Economic Cooperation and Development (OECD) describes corporate governance as "a set of relationships between a company's management, its board, its shareholders and other stakeholders." At first glance this statement isn't particularly earth shattering. If anything, it's painfully obvious.

But if you focus on the word "relationships" — a word that lies not only at the heart of the sentence but of corporate governance as well — things get more complicated. Why? Because relationships among these groups are anything but simple. They're what negotiation experts call "mixed-motive" relationships, and they're exceedingly prone to breakdown and failure.

Consider a recent Booz Allen Hamilton study of the world's 2,500 largest publicly traded corporations. Calling record-high turnover among executives "the new normal," this study reports that forced turnover among CEOs rose 318% since 1995. In 2006, one out of every three CEOs left involuntarily. Nearly a quarter of the forced departures followed from conflicts with the board — up from 2% in 1995. In each case, shareholders ended up footing the bill.

Diana McLain Smith is the author of *Divide Or Conquer: How Great Teams Turn Conflict into Strength* (Portfolio/Penguin USA) and a partner at the Monitor Group, a global management consulting firm. Her Web site is www.dianamclainsmith.com.

These statistics reflect at a macro level pervasive turmoil at a human level — turmoil that can only be understood by looking at the shifting relationship between boards and CEOs.

Unable to see eye-to-eye, the chairman and the CEO brought the worst out in the other.

Two cases I studied illustrate the point. In the first, a young entrepreneurial CEO of a fast-growing firm was under siege from her board after an especially tumultuous year. While the firm's results were still strong, the board's activist chairman quite rightfully worried about the organization's longer-term health. Why was there so much turnover in the higher ranks? Why wasn't she sticking to the firm's strategy? Was she too volatile and opportunistic to take the organization to the next level? These are exactly the kinds of questions boards are charged with asking and CEOs are charged with answering.

Chairman's tirade

Yet that isn't what happened. Instead, having privately reached his own conclusions, the chairman more or less subtly launched one criticism after another at the CEO. Feeling undermined and outraged, the CEO retaliated in kind, countering each "attack" with one defensive maneuver after another. Unable to see eye-to-eye, each brought the worst out in the other, making it impossible for them to fulfill their governance responsibilities. Indeed, far from creating value for the organization, their relationship was systematically destroying it. Had the two not had the good sense to get help, the CEO might easily have ended up as just another statistic.

In the second case, just the opposite happened, but with similar results. Despite mounting worry over an 18-month period, the board members of a well-known manufacturing company were unable to stop the firm from slipping ever further into the doldrums. The company's CEO, who fancied himself a master at "managing" public boards,

Continued on page 63

Heart of the matter

Continued from page 64

spent days every quarter preparing air-tight presentations that anticipated every possible question, challenge, or criticism that might come his way. The board, discouraged by the CEO's pat presentations yet loathe to interfere in his management of the firm, tacitly complied. It wasn't until the firm's stock price collapsed that the directors finally took action, firing the CEO and half his team.

In an ideal world, cases like these would be the exception, not the "new normal." In that ideal world, boards and CEOs would jointly define their company's strategic challenges, jointly identify the information needed to address them, jointly assess the CEO's developmental needs, and jointly ensure accountability for results. In the real world, this happens all too rarely. Why?

Because we have our attention so squarely focused on individuals — on their personalities, their performance, and their potential — that we pay little attention to the quality of the relationship between a company's management and its board. Yet my studies suggest that these relationships have a profound, even decisive impact on a CEO's personality and performance and whether he or she can realize a firm's full potential.

The relationship with the board has a decisive impact on a CEO's personality.

The bottom line is this: good governance depends on good relationships. When relationships break down, neither boards nor CEOs can effectively fulfill their governance duties. As boards continue to redefine their roles and become more active, it's imperative that they give relationships the time and attention they require.

When the entrepreneurial CEO and her board chair did just that, they successfully worked together to change the polarized dynamics that were undermining her ability to lead and their collective ability to govern.

A year later, the problems that so worried the chairman and thwarted the CEO were no longer an issue, and the two were able to put their attention where it most belonged: on growing the enterprise. ■

The author can be contacted at dianamsmith@comcast.net.