How can the board of directors create value? V4

What is the purpose of this article?

1) Provide a framework and process to enable discussion and action planning among owners/shareholders, boards of directors, and CEOs regarding the directors' role in creating value.
2) There is no one-size-fits-all answer. The approach and action plan will be unique to the specific situation of each corporation.
3) The article does not address the implications of: shareholders agreements, voting trusts, term of loan agreements, the authority of regulators, and others who can make decisions or limit the value creation power of the board.

This article does not provide legal or financial advice.

What are the critical learnings in this article?

1) You must have clear agreement who has the ultimate accountability for long-term company performance and value creation.
2) Companies can both create and destroy value for the ecosystem members.
3) There are 7 inter-related components of talent.

Who is ultimately accountable for the long-term success of your company?

1) Boards are ultimately responsible for the long term success of their organizations**.** [1]
2) My discussion around boards creating value assumes that boards are ultimately accountable for creating value. If this is not the case for your company, there's no need to read further.
3) Many discussions regarding the value of directors use words such as "oversight", "noses in, fingers out", and other vague definitions of board accountability. It's critical to be absolutely clear regarding board accountability.

What is value, and value to whom?

Is value (or wealth) simply the financial returns to shareholders and the C-Suite? Ecosystem members may have varied and conflicting perspectives regarding benefits and costs they incur.

The corporation can both create and destroy value (both benefits and costs) throughout its ecosystem. An example of value destruction is increasing worker compensation below the rate of inflation.

How is value creation (benefits) and value destruction (costs)allocated among members of the company's ecosystem ? e.g. the directors, management, employees, shareholders, , and society? For example, if an unprofitable facility is shut down in a region with no other employment, who should bear the cost of keeping the former employees fed and housed? Should the corporation focus on shifting as many costs as possible onto society and minimize the benefits provided to society?

What is the company's ecosystem?

The company's ecosystem is the network of people and organizations, including stakeholders and third parties, directly and indirectly involved in the operation of the business through both competition and cooperation. The idea is that each entity in the ecosystem will affect and is affected by the others, creating a constantly evolving set and nature of relationships in which each entity must be flexible and adaptable in order to survive, as in a biological ecosystem. The actions and behaviours of the ecosystem vary, depending upon what attribute of the company is considered. For example, the ecosystem has different behaviours when regarding the second to second corporate delivery of products or services versus when the company is dealing with CEO succession.[2]

What are the seven components of talent?

#1 Self-awareness: e.g. Does each director understand their strengths, weaknesses, capabilities? Do they understand how others perceive them?

#2 Character: e.g.

1) Values, morals, and ethics. Warren Buffett supposedly said "…looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if you don't have the first, the other two will kill you."
2) Courage: It takes courage to make the right decision. The right decision is often not: the cheapest, easiest, lowest risk to the company and director, nor what everyone else is doing.

#3 Relationship skills: e.g. Ability to create and sustain a network of personal relationships. This includes persuasion and negotiation, which is key to managing different points of view and interests. Creating and maintaining followers. A leader without committed followers is not a leader.

#4 Crystallized intelligence: e.g. what skill, knowledge, ways of thinking, mental paradigms, and facts must the managers have. It is key to have current and relevant information.

#5 Fluid intelligence: e.g.

1) The ability to solve problems without past experience. This is critical for innovation, which is coming up with new and better solutions.
2) The future is impossible to predict but the directors actions and decisions are focused on this unpredictable future.
3) The future will also be different from the past. i.e. there won't be historical experience to draw upon.

#6 Cognitive skills: e.g. Able to collect and do fact-based analysis with sound logic and reasoning.

#7 The ability and interest to learn, and unlearn, quickly.

How does board talent impact value creation and growth?

1) The board's VME sets the tone for the culture of the board, C-Suite and the entire company. What are the stories that people tell about what they see directors do and say?
2) Approving and committing to the purpose of the corporation. The purpose remains fixed while operating practices, cultural norms, strategies, tactics, processes, structures, and methods continually change in response to changing realities. [3] Many employees, including the C-Suite seek alignment between their personal purpose and the purpose of the company. This can especially true for the most talented employees, whose rare skills are in great demand.
3) Approval of the decision making process and principles for the board and C-Suite.
4) Approval of the long-term value creation plan which include the long-term cash flow forecast, capital allocation, and talent creation/allocation. The scope of the talent creation/allocation includes; the individuals on the board and the C-Suite, and policies for the rest of your company. The board approves: director nominations (directors are elected by shareholders), compensation, development and succession processes. The board also approves and oversees the succession pool and development processes for potential C-suite successors.
5) The board approves the delegation of authority to the CEO and awareness process i.e. Does the CEO make the decision and not inform the board OR make the decision and then inform the board OR make the board aware of the decision prior to making the decision OR discuss the decision with the board.
6) The board approves policies which constrain the decision making of the board and the company.
7) Directors create and maintain relationships with members of your company's ecosystem. Those relationships provide external knowledge. Relationship with potential customers, suppliers, and employees can enable growth. Relationships with investors, regulators, NGOs and others can help directors understand the implications of their decisions.

The board also decides how to allocate value creation and value destruction among: directors, management, employees, shareholders, and other members of your company's ecosystem including society.

What about the processes and technology supporting the board?

1) Board value creation can be enabled, or hindered, by processes and technology.
2) Does your board know what processes and technology are required? This refers back to skill #4 above, crystallized intelligence.

What are your next steps?

<u>Questions for your board and CEO/management to consider.</u>

Ask the following questions and document the agreed upon answers, as well as points of disagreement. Remember, the Supreme Court does not always have a unanimous point of view.

1) Is your board ultimately responsible for the long term success of your company? If not who is, and what is the board accountable for?
2) How do you measure the board's collective impact on value creation?
3) How do you measure each individual directors impact on value creation?
4) How do you measure the competitive differentiation of the board as a whole and of each individual director?
5) How to you measure the skills of current and prospective directors?
6) What value has the company created, or destroyed? For shareholders, employees, other members of the ecosystem? Compare this to others in the industry and more broadly.
7) If your company is a global leader in value creation, why, and what role did the board play?
8) If your company is not a global leader, what actions and behaviours must your board directors take? What talent must each director have?
9) You must be specific regarding director actions and required talent. E.g. What if the board considers CEO appointment or termination as one of the biggest impacts on long-term value growth. Must a director have had experience in and accountability for: the appointment and termination of CEOs? Or C-Suite members? Or middle

management? Or is any experience at all required? If experience is required, how many directors of those voting on the CEO appointment/termination must have relevant experience? All directors? Majority? One?

10) How is the value creation role of the directors reflected in formal governance documents, including: board mandate, board chair mandate, committee and committee chair mandates, etc.
11) Do the directors have the potential to change, with coaching, or must they be replaced?
12) Review the director onboarding process. Consider having potential directors as board observers for one-year prior to nomination, at full compensation. This is critical part of potential director assessment.
13) Recognize that the directors are not advisors to management. Create an advisory board for the CEO.
14) The directors may need external advice from subject matter experts with extremely deep domain expertise. Create an advisory board for the board.
15) What is your action plan, if any?

Footnotes

[1] Professor Didier and Estelle Metayer, "Does your board really add value to strategy?", IMD, Global Board Center, https://www.imd.org/research-knowledge/articles/board-strategy/

[2] Adapted from Investopedia 2018 May 11

[3] Page 17 The five most important questions you will ever ask about your organization (2008) by Peter F. Drucker, Jim Collins et al, I adapted.

What further reading should you do?

1) "Seven essential elements of a lifelong learning mindset, McKinsey 2019 February 19" Exhibit 3 points out that you should be developing new deep domain expertise well into your late 870, early 80s. You must be continuously unlearning. https://www.mckinsey.com/capabilities/people-and-organizational-performance/our-insights/seven-essential-elements-of-a-lifelong-learning-mind-set
2) What is corporate governance? http://koorandassociates.org/corporate-governance/what-is-corporate-governance/
3) Jeffrey Sonnenfeld, Melanie Kusin, and Elise Walton "What CEOs really think of their boards.", Harvard Business Review 2013 April, https://hbr.org/2013/04/what-ceos-really-think-of-their-boards
4) *Larry Fink's* 2018 *letter* to *CEOs* on how companies must have a social purpose and pursue a strategy for achieving long-term growth. https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter
5) Mark Leonard, CEO of Constellation Software, his final annual CEO letter. "Qualified and competent Directors are very rare, and not surprisingly, the track record of most boards is awful. According to the 2017 Hendrik Bessembinder study of approximately 26,000 stocks in the CRSP database, only 4% of the stocks generated all of the stock market's return in excess of one – month T-Bills during the last 90 years. The other 96% of the stocks generated, in aggregate, the T-bill rate over that period. This means that 4% of boards oversaw all he long-term wealth creation by markets during that period. Even more disturbing, the boards for over 50% of public companies saw their businesses generate negative returns during their entire existence as public companies. " His 2018 April 20 letter also includes "CSI Board Role Search Criteria" " http://www.csisoftware.com/wp-content/uploads/2018/04/Presidents-Letter-April-2018-Final.pdf
6) This article suggests enhancing the board's role in value creation three ways: assessing the full suite of options for value creation; evaluating how strategic options affect total shareholder return; and understanding long-term shareholders' views on value creation. The authors are from: Norton Rose, BCG, and RBC Capital Markets http://www.nortonrosefulbright.com/knowledge/publications/137271/beyond-governance-a-canadian-perspective-on-preempting-shareholder-activism-through-value-creation
7) "Five ways to increase your boards long-term impact" McKinsey Survey, July 15, 2022 https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/five-ways-to-increase-your-boards-long-term-impact?cid=other-eml-alt-mip-mck&hdpid=b7966529-4ace-409e-87ae-8bceb84778c9&hctky=1434538&hlkid=3cc48150fe5644efb7816cd4bdc953a7