Coming Soon To Corporate Governance: Common Sense

By Mark W. Sickles

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Common sense is not so common, and is the highest praise we give to a chain of logical conclusions.

–Eli Goldratt, "The Goal"

The need for proof of assertion decreases as lucidity and logic increase.

–Albert Einstein

In order to transform corporate governance into a "common sense" chain of logical conclusions worthy of our highest praise, we need to break the chain of conventional wisdom and past practice. The key ingredients to this breakthrough opportunity are the courage and commitment to challenge basic assumptions and the traditional ways of doing things. Let's start by challenging one of governance's best known sacred cows: "noses in, fingers out."

Noses in, fingers out—NIFO—has been a clever way of making the valid point that management "does" and the board "assures." If we're talking about Colgate-Palmolive or American Standard, where being on the board has been like being the Maytag repairman, you can most likely get away with the NIFO approach to corporate governance. But if the dam is about to break, as it has in far too many firms, then this approach is not only unacceptable; it's indefensible. As Dr. Curtis Crawford, author and *Fortune* 500 corporate director pointed out, the line between effective board and management activity is a *floating* line, whose position depends both on what's happening and what's about to happen. *[Ed. Note: Curtis Crawford's article, "The Enlightened Board," will appear in the December 2007 issue of* Directors Monthly.*]*

Director Summary: A common sense approach to governance is one that is "floating." In this context, a floating approach means that management and the board must work in concert to create an ethical environment that increases shareholder value. The author's toolkit for such collaboration is outlined in the engaged enactment of four director roles—fiduciary, advisor, overseer, and advocate—leading to the smooth operation of four management systems—finance, strategy, organization, and operations.

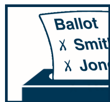
Unlike "fingers out," the mantra that "the board assures" is absolute and timeless. If board members have to insert their fingers, bodies, minds, hearts, and souls to assure shareholder value, then common sense says that's what the shareholders are paying them to do. This challenge brings to mind former NFL coach Bill Parcells's definition of the roles of offense and defense: The role of the offense, Parcells said, is to score more points than the defense gives up; and the role of the defense is to give up fewer points than the offense scores. The genius of these definitions is that if either the offense or defense fulfills its role, the team wins every game. Like Crawford, Parcells understands that an anchored commitment to winning requires a floating approach to teamwork.

If the roles of the board and management can similarly be defined, so that when *either* is fulfilled, long-term shareholder value is present, it makes no sense to define these roles in any other way. Yet time and time again, firms do just that.

Common Sense Corporate Governance

Is your board of directors ceremonial or enlightened? Detached or effectively engaged? Do they have the capability to function as a strategic asset and competitive advantage? Because of your management team's interactions with your board, are your firm's assets more secure? Strategies better formulated? Organizational ability to implement strategy enhanced?

These questions are consistent with a new notion of "ethical behavior" and sound governance embedded in a principle-based system of questions—originally designed for boards—that security analysts are beginning to ask investor relations officers and CFOs, thereby significantly increasing the transparency of information essential to sound investment decision-



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making. Firms providing the right answers to these questions will be revealed as superior investments compared to alternative investments of comparable risk. Why? Because the answers to these questions reveal whether or not common sense—a sound chain of logical conclusions—is present or missing inside the boardroom when directors and officers interact to fulfill their common purpose on behalf of employees, customers, and shareholders: building a great place to work, buy, and invest.

This emerging dynamic between analysts and officers spotlights what analysts and corporate directors have always had in common: When *either* of them asks questions of management, management always wants to have a good answer. In a common sense approach to global business, enlightened analysts are as committed to functioning as strategic assets and competitive advantages as enlightened directors, understanding they can have just as much impact on the creation of long-term shareholder value. This growing movement towards a common language, common ground, and common cause for the inextricably linked fields of corporate governance, long-term shareholder value, and investment decision-making, is just good old common sense with breakthrough implications.

Ethical Behavior

Shareholders have the right to expect that their boards and directors behave ethically and practice sound governance. In working with The Rutgers Prudential Business Ethics Center, we have developed a new definition of ethics: "The effective management of the intersection of competence and organizational integrity." Against this definition of ethics, it is unethical to even interview for a position—especially a leadership position—if you know in your heart you are not competent to perform the duties at a level of excellence.

In terms of integrity, we recommend a primary emphasis on structural, systematic integrity—enterprise soundness—more than an emphasis on individual integrity—openness and honesty—simply because there's much more leverage in the former. Experience demonstrates that you can have open and honest individuals working in structurally *unsound* organizations, but you cannot have deceptive and dishonest people working over the long term in structurally *sound* organizations because their deception and dishonesty causes a breakdown in organizational integrity. Counterintuitively, the weakest link in the chain—in this case, individual deception and dishonesty—is actually the strongest link because it can break the entire chain—the organization—when firm-level integrity and soundness are tested.

Fulfilling the responsibility for ethical behavior and sound governance requires directors and officers to anchor their commitment to excellence in the mastery of their own form of floating teamwork. The competency toolkit for doing so already exists, having been the featured theme of a 2006, four-part series of interdependent programs delivered to NACD members and guests by the New Jersey Chapter of NACD. This series was introduced under two fundamental premises:

- Post-Enron, directors and officers are seeking to master sound governance: functioning as strategic assets and competitive advantages to formulate and implement strategies producing long-term shareholder value, all while behaving legally, ethically, and morally.
- In spite of their best efforts, many directors and officers feel they are coming up short.

The purpose of the series was to provide directors with the toolkit needed to play the four fundamental roles of the board—fiduciary, advisor, overseer, and advocate—so that, with and through management, they could meet and exceed the raised bar of shareholder expectations. The four parts were as follows.

Part One—The Fiduciary Role: Asset Protection

Traditionally, asset protection has meant complying with governing rules and regulations, behaving prudently, and taking only calculated risks; in short, playing defense. But as the saying goes, the best defense is a good offense: The best way to protect shareholders' assets is to ensure these assets are stronger and more robust than those of your competitors. A solid offensive plan for protecting shareholder investment is to develop an asset utilization plan to produce operating income greater than the annual cost of those assets, greater than that produced by the firm's competitors. This balanced approach to asset protection—both defensive and offensive—creates an effective financial context for the remaining three roles of sound governance.

Part Two—The Advisor Role: Strategy Formulation

Strategy is best defined as an integrated and coordinated set of commitments and actions designed to first develop and then exploit strategic assets, to produce sustainable competitive advantage and long-term shareholder value. The asset protection role quantifies long-term shareholder value, thereby serving as a contextual framework for strategy formulation. In sum, effective strategy formulation assures that management does the right things.

Part Three—The Overseer Role: Strategy Implementation

Strategy implementation assures a smooth operation by focusing on efficiency. This calls for developing and utilizing a management system to achieve the end goal of long-term shareholder value. The key to success here is a masterful understanding of both entity and procedural interdependencies—the anatomy and physiology of business organizations. When used effectively, this management system maximizes integration and coordination, which increases the firm's ability to respond to the demand for change caused by external forces beyond its control. In sum, efficient strategy implementation assures that management adapts and adjusts to maintain a smooth operation, on a straight course that leads to long-term shareholder value.

Part 4—The Advocacy Role: Marketing and Selling the Company

In carrying out the sound governance roles of asset protection, strategy formulation, and strategy implementation, directors can play the advocacy role with great enthusiasm: marketing and selling the company to current and prospective employees, customers, and shareholders as a great place to work, buy, and invest.

These four board roles—fiduciary, advisor, overseer, and advocate—are carefully designed to complement and reinforce four fundamental management systems for which the officers of the firm are responsible: finance, strategy, organization, and operations. The premise of the late Peter Drucker's book, *Managing in the New Society,* is that business failures are systems failures rather than human failures. This is why CEOs and top management teams should spend more time working *on* the business than *in* the business. As Drucker wrote years ago, "Every organization is perfectly designed—for the results it produces."

To assure top management spends enough time working on the four business systems to enhance the performance of the employees working in these systems, boards should learn the art of leading with the question mark rather than the exclamation mark. I have yet to meet a board member who does not readily agree that boards create work in organizations when they ask questions. So why not ask questions that design the work of management into a form that produces strategic assets, sustainable competitive advantage, and long-term shareholder value? A system of questions designed exactly for this purpose is readily available to any board member willing to push aside conventional wisdom and become a driver of effective actions leading to long-term value creation.

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When boards master their four roles in ways that cause management to master their four systems, leading to an organization of ordinary people producing extraordinary results, directors and officers will be working together as partners on behalf of the shareholder. In the context of newly enlightened security analysts seeking to reinvent themselves into drivers of long-term shareholder values, shareholders are increasingly seen as the common customer of directors, officers, and the investment community. It becomes equally clear that the board and top management have the same task—to deliver long-term shareholder value, by practicing "floating teamwork." And like Parcells's notion of a good football team, it becomes clear that, if long-term shareholder value is missing, neither the board nor top management did their jobs.

MCI CEO Mike Cappellas's closing comments from a 2006 keynote speech at Drexel University's LeBow College of Business Center for Corporate Governance, following a year in which he held 57 board meetings, captured the essence of this board-management interdependence: "Good governance equals great management, and great management equals good governance." Now that's common sense! ■

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