What's Keeping Board Members Awake These Nights?

We may not be out of the financial woods yet, but welcome indications of an economic recovery suggest the coming year could also be one of opportunities.

A recent report from Deloitte LLC's Center for Corporate Governance lists the key issues that Boards – whether they're for-profit or not-for-profit – are struggling with now that the worst economic challenges are beginning to recede into the background.

As the report states, there's no single preferred approach to addressing any of these issues – the right ones for each organization will depend on its own circumstances. Instead of providing answers, the report is designed to help promote board/ management discussions as they begin tackling the challenges and seizing the opportunities ahead.

Risk Management

The financial crisis exposed many organizations' risk management practices as being less robust than initially expected. A key lesson for boards arising from the crisis is the critical need for effective risk management and the value of increasing their organization's resilience to risk.

Risk management policies, processes and procedures are important components of risk management, but they alone are not enough. Effective risk management requires having a culture that enables an organization to make "smart" risk-related decisions, such as how much risk the organization will take on and how those risks will be managed and mitigated so the organization can both preserve and create value. In risk-intelligent organizations, risks and rewards are linked in the organization's strategic plan.

Effective risk intelligence depends upon the board and senior management clearly understanding the principal risks facing the organization. Since the scope of the risks facing organizations is wide, organizations must continuously review and assess their inventory of risks to identify those with the greatest potential impact that need to be understood in detail. This information must be communicated so the board and management can factor it into their decision-making process.

Questions Boards Need to Ask

- Do we have a risk-intelligent culture?
- What is our organization's risk appetite and how do we manage and mitigate its risks?
- Do we link risk and reward in our strategic planning?
- Have we identified all of the risks facing the organization and do we keep that list of risks regularly updated?
- Do we fully understand those risks? How well do the board and management factor

this understanding into their decision-making process?

Strategic Planning

Setting the organization's strategic direction is one of the board's primary responsibilities, although many boards devoted less time to it during the past several months as they addressed urgent, short-term challenges. With some indication that economies are beginning to recover, all boards should now begin refocusing on their key strategies, particularly since most pre-crisis strategies are unlikely to apply during the economic recovery. Organizations will need new strategies to address their new business realities.

Strategy is a combination of the future direction of the business and the concrete steps the company takes to get there. While setting strategy is generally management's job, the board's role is to oversee and ultimately approve management's strategic plans. Boards should advise and challenge management while applying their independent perspective and expertise to the proposed direction management sets out for the organization.

Given this role, the board must enjoy a strong working relationship with management if they are to work together to develop an effective strategy. Such a relationship is necessary if the board needs to ask the tough questions (such as, "What if this fails?") that trigger rethinking and additional work by management.

Action plans that support the strategy should be aligned with the organization's agreed-upon strategic objectives as well as its risk profile. The board should provide input during the scenario planning analyses to ensure that the strategic plans address all of the relevant internal factors (e.g., resources) and external factors (economic conditions, competition and stakeholder expectations) as well as the risks associated with each of those factors.

The board should help define an appropriate strategic timeline and ensure that it balances long-term strategic plans with short-term goals.

Given the many issues boards must address at their meetings, a leading practice of many boards is to devote additional time for strategy discussions during an annual retreat with management. With or without separate time devoted to strategic questions, strong boards devote adequate time as part of their agendas to enable an ongoing and continuous review of the organization's strategy.

Questions Boards Need to Ask

- How much time does our board spend on strategic discussions?
- Should we have a retreat with management to discuss strategy?
- Do we set aside enough time on our agenda for discussions about strategy?
- Does management provide the board with the right information, the right amount of information, and in the right format to enable the board to effectively and productively challenge the short- and long-term strategic objectives and ultimately

approve the organization's mission?

- Is our strategic plan aligned with the organization's risk appetite?

Succession Planning

The economy may have become the priority item for many boards of directors over the past year, but succession planning remains an important issue that boards cannot afford to ignore.

A well-planned CEO succession planning process is critical to the long-term stability of every organization. Succession planning should be a continuous, board-driven process that enables the board and organization to proactively identify and develop candidates, thereby avoiding the need to search for candidates under pressure.

Since organizations evolve continuously and their circumstances inevitably change, it is important to identify candidates with the right skills to meet the organization's needs both today and in the future. Therefore, before launching a search, boards must ensure that they have identified the desired skill sets and that they will be sufficiently objective about assessing each candidate's strengths and weaknesses against those criteria.

Boards may wish to delegate their succession planning process to a committee of independent directors. External executive search consultants can also assist boards with their succession processes. While the CEO is usually responsible for recruiting and developing his or her management team, the board may wish to provide oversight to this process to assure itself that sufficient opportunities exist within the organization to support a leadership pipeline. Such oversight also provides additional means for a board to build its own relationship with members of senior management and become familiar with future candidates for company leadership.

Documenting the succession planning process helps ensure that it addresses all important issues and helps the board keep track of the process. In addition, the board should review its succession planning process at least annually, and revise it as necessary to reflect the organization's current and future needs, strategic objectives and other circumstances.

Questions Boards Need to Ask

- Is succession planning included in the board's agenda?
- Are the succession planning objectives well defined and aligned with the organization's strategic objectives?
- How prepared is the organization for an unexpected resignation of the CEO?
- Has the board evaluated the risks that the organization would face if the CEO had to step down suddenly?
- Does the board have an up-to-date understanding of the skills and knowledge required of the CEO?

- Are there candidates within the organization that meet this profile?
- Is the board aware of the processes management has implemented to attract, develop and retain talent in the organization?

Member & Stakeholder Relations

One focus in today's scrutiny of governance arrangements is the relationship between organizations and their stakeholders. The board needs to understand its stakeholders, the issues of importance to them and their expectations of directors. With this knowledge, the board can factor stakeholder objectives and preferences into their deliberations and better communicate the board's decisions, particularly about strategy and risk management.

Management is usually responsible for communicating on behalf of the organization. Boards have historically had only limited communications with shareholders - most often, presentations at annual meetings or written statements in the annual report.

Today, some boards are expanding these traditional communications by initiating face-to-face meetings with key stakeholders and may even identify one or more directors as a key contact on the board for stakeholders wishing to communicate.

Boards that want to expand their dialogue with stakeholders should develop a strategy for doing so. However, it is important that the board's conversations focus on matters of governance and do not delve into issues of management.

Questions Boards Need to Ask

- Do we have a strategy for communicating with our stakeholders?
- What steps can the board take to better understand the expectations of its stakeholders?

Chair's Role

Many boards of directors are taking greater roles in leading their organizations through the global financial crisis as they revisit strategies, review business assumptions and reset expectations for performance.

Today, board chairs are challenged to maintain the delicate balance of often conflicting priorities: managing stakeholder expectations, building relationships with management (especially the CEO), driving oversight and leading the board.

Separating the roles of the CEO and Board Chair is not always without its challenges. Many organizations with a separate Board Chair and CEO seek a stronger "partnership" between the two positions to better lead the organization through difficult conditions.

The relationship between the CEO and Board Chair requires constant recalibration. To help manage this relationship, boards should consider a number of issues including determining the optimal balance of power between the CEO and chair; deciding upon the appropriate level of dialogue among executive management, the board and the board chair; and figuring out how to clarify the often-blurred boundaries between insight, independence and oversight.

A strong relationship between the CEO and board chair should lead to a more open relationship between the board and executive management. Board chairs, however, will need to take care to balance an effective working relationship with the CEO and maintaining their own independence.

Questions Boards Need to Ask

- Have we clearly defined the roles of the CEO and board chair?
- What is the optimal balance of power, and has this been affected by changing economic circumstances?
- How do we effectively maintain the balance between independence and knowledge?
- How do we divide the ownership of issues between management and the board, and especially the board chair?
- How do we determine who is responsible for financial performance, stakeholder management and shareholder value?

Board Selection

Organizations that will be the most successful in working through the financial crisis and seizing the opportunities when global economies recover will be the ones with the right strategies in place and the resources and capabilities to execute them effectively. One of those critical resources is a high-quality senior leadership team including the board of directors.

Boards of directors should periodically review their composition to ensure that directors have the aggregate skills and expertise the board needs to carry out its responsibilities effectively, and undertaking such a review may be particularly important in 2010. The financial crisis has transformed global economies and radically changed many organizations' operating environments.

A review of the board's composition should focus on identifying any skill gaps that may exist among the directors. Similarly, the expertise of some current directors may no longer be required by the board given the changes in the organization. In addition to knowledge and skills, boards may also wish to adjust their membership to reflect the diversity - age, gender, nationality, etc. - of the organization's stakeholders.

With a structured review and rotation plan, boards can achieve the benefits from adding new talent to revitalize themselves without disrupting continuity and losing their "collective memory" of past decisions. In some cases to facilitate the knowledge transfer from one generation of directors to the next, and help ensure that departing directors are recognized and appreciated for their past service, boards may consider establishing an advisory committee comprised of directors transitioning off the board, which would enable them to provide ongoing advice and support to the board.

Questions Boards Need to Ask

- What changes have occurred in our organization and it operating environment?
- How have these changes affected our organization's direction, markets, operations and other activities?
- Does the board have the necessary knowledge and expertise to provide effective oversight of the organization and its activities in this changed environment?
- How often do we review the composition of our board?
- Has our review identified any skill gaps among the directors?
- Are there directors whose skills are no longer applicable to the organization's needs?
- Do we have a structured review and rotation plan that enables the board to adjust its membership in a way that revitalizes the board without disrupting continuity?
- Do we provide a mechanism for past directors to continue to act as advisors to the board?
- Are we recruiting new directors to the board with the right mix of skills and experience to enable the board to meet its present and future challenges?
- Does the board reflect the diversity of our shareholder group?

Performance

Boards of directors face continuously increasing demands and challenges to their effectiveness. But while the demands and responsibilities of boards increase, the time available to them to address these challenges remains relatively constant. Success, therefore, depends upon increasing the effectiveness and efficiency of the board, and the key to doing that is through a robust board evaluation and director education process.

Regular board assessments enable the board to examine its structure, processes and mandate to ensure they are properly positioned to address current and future priorities. They can help the board better understand the aggregate skills and expertise of directors and identify areas of weakness. They can also help improve the interaction of directors and communications among them. Like any evaluation process, the benefits achieved through the board's assessment will only be as good as the review process.

Good assessment programs are supported by a director education program that addresses the needs of directors identified through the evaluation process. Additionally, many boards find their evaluations are most effective and productive when the process is led by an independent, outside facilitator.

Questions Boards Need to Ask

- How do we assess the performance of the board and its committees?
- Does our evaluation process provide the board with useful, focused feedback that enables us to improve performance?
- Do we update our evaluation criteria to reflect the changing demands placed on the

board and the organization?

- Does our process effectively identify directors' education and development needs?
- Do we follow through with appropriate learning programs?
- Does our assessment process help us improve communication and interaction between board members, and strengthen the board's ability to work effectively as a team?

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