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Getting Engaged: The Art and Science of Improving Board Performance

Too many boards rely on outdated governance models that undermine their efforts to create value. A new approach, the engagement theory of governance, meets 21st-century challenges head on.

Company boards today are wrestling with an unprecedented array of challenges on multiple fronts. Activist investors demand drastic, immediate action to boost profit margins. Regulators around the world impose costly new requirements and expose companies to embarrassing publicity for compliance failures. New competitors and rapidly evolving technology upend market dynamics and undermine established business models. All the while, an expanding chorus of social and traditional media outlets calls out companies for failing to meet various external performance benchmarks.

Boards are trying to **shake the insularity of the past** by adding new directors.

Aware of the need for change but unsure where to turn, many boards are in a state of flux. They're trying to shake off the insularity of the past by adding new directors with diverse backgrounds and business perspectives. And they're looking for ways to meet escalating demands for stronger operational results at the companies they oversee.

Yet few boards can say with full confidence that they have found a formula for effective corporate governance in the modern era. Indeed, research shows boards fall short in key areas. A recent report by the London Business School's Leadership Institute concluded that while there are some pockets of good practice in the boardroom "boards have some way to go to reach their fullest potential."[1]

Other studies enumerate a range of shortcomings in board performance:

- Boards are struggling to navigate the challenges of digitization.[2]
- Boards aren't prepared to tackle pressing strategic challenges.[3]
- Flawed decision-making processes, compounded by excessive social cohesion, prevent open, constructive boardroom debate on crucial issues.[4]
- Perhaps most importantly, many boards fail to ensure their companies meet core performance targets for return on investment and profitability.[5]

The state of corporate governance today suggests the lessons of the financial crisis have gone largely unheeded. Many boards have yet to address governance gaps that contributed to the collapse of major firms around the world. Even directors of financial institutions—the industry at ground zero of the 2007-2008 market meltdown—remain unaware of myriad operational risks that could disrupt their far-flung organizations.

Why do 21st-century governance challenges confound so many boards? Because they're trying to meet those challenges with 20th-century governance frameworks, behavioral paradigms, and organizational processes. Outdated thinking and methods impede their efforts to grasp crucial issues and oversee management effectively.

1 Beyond Governance – How boards are changing in a diverse, digital world, LBS Leadership Institute and Harvey Nash (2016)
2 It's Time for Boards to Cross the Digital Divide, HBR (July 2014)
3 2016 Global Board of Directors Survey, Spencer Stuart (April 2016)
4 How DuPont's Directors Failed, Yale Insights (October 2015)
5 Study of Australian Leadership, Australian Department of Employment

Our conversations and engagements with clients confirm the need for a governance framework that helps boards focus and align around top priorities, while fostering greater agility and speed in decision-making. To create value amid complexity, boards need new guiding principles and practical tools derived from research and hard data, not custom and anecdote.

Better Boards and A.T. Kearney have developed an approach that links evolving theories of governance with empirical research, real-world experience, and a deep understanding of the factors that drive board performance. Boards that adopt the "engagement theory" of governance can develop the insight and flexibility to respond appropriately to ever-changing threats and opportunities, along with the trust and confidence to encourage spirited internal debate that leads to better decisions.

This paper describes the characteristics of an engaged and effective board and outlines the initial steps to creating one. But first, we'll examine the theoretical underpinnings of corporate governance and how they have shaped board practice over the years.

Governance Frameworks: A Brief History

Corporate governance structures and processes in use today are rooted in theories dating as far back as the 1930s (see figure 1). Each theory arose from the conditions, attitudes, and experiences of its time. *Agency* theory, for example, emphasized separating ownership and control, reflecting a prevailing mistrust between shareholders and managers. Assuming that executives couldn't be trusted to make sound judgments, this model imposed strict controls on management. Many such control mechanisms have remained in place, even as directors came to trust the judgment and expertise of professional executives.

Figure 1
Theoretical frameworks of board governance

Theory	Contextual assumptions	Mechanism	Intended outcome
Agency	Low trust, high challenge, and low appetite for risk	Control through intense external and internal regulatory performance monitoring	Minimization of risk and good performance
Stewardship	High trust, less challenge, and greater appetite for risk	Board support in a collective leadership endeavor	Organizational improvement and excellence in performance
Resource dependency	Importance of social capital of the organization	Boundary spanning and close dialogue with business partners	Improved reputation and relationships
Stakeholder	Importance of representation and collective effort; risk is shared by many	Collaboration	Sustainable organization; high staff morale

Source: Chambers et al., 2013

As trust increased and companies grew more comfortable with risk, new governance models emerged. *Stewardship* theory assumes managers and owners share common goals, such as organizational improvement or excellence in performance. Working together, they support each other in a collective leadership endeavor.

Another major influence on governance practice is *resource dependency* theory, which holds that organizational survival depends on access to external resources. Boards play a central role in securing those resources, linking external and internal constituencies and connecting with potential business partners outside the company.

Boards also have been called upon to act as representative bodies giving voice to various "interest groups." *Stakeholder* theory posits that a board should set aside seats for a wide range of constituencies, such as employees or functional organizations within the company.

While each of these theories has merit, research and experience reveal that none gives boards all the tools and insights to deal with increasingly complex business and economic environments. What's needed is an intelligent 21st-century blend that combines the best characteristics of each. *Engagement* theory achieves this optimal mix by fostering a high degree of trust between directors and executives, while drawing on the distinct experience and insights of each board member, encouraging directors to challenge each other and management in healthy dialogue, and enforcing broad-based accountability for results (see figure 2).[6]

Figure 2
Engagement theory blends high trust, high challenge, and high engagement

Theory	Contextual assumptions	Mechanism	Intended outcome
Engagement	Complexity, competing priorities, and pressures	Close oversight and use of all above mechanisms as required	Flexible, high-performing, outward-focused organization

Source: Chambers et al., 2013

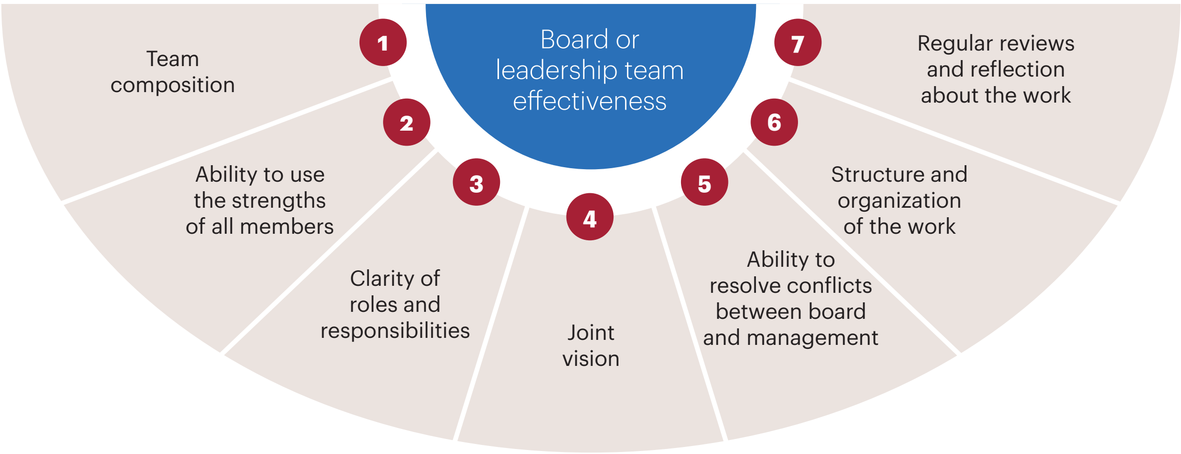
The Seven Hallmarks of an Engaged, Effective Board

What does an engaged board look like? There is no standard profile. Any "best practices" in this area are no more than guiding principles. Boards that mimic governance frameworks that work well for others often overlook cultural differences that drive performance at various companies.

Generally, however, engaged and effective boards share seven essential traits (see figure 3 on page 4). Our research indicates these hallmarks appear in successful companies of all sizes, across geographies and industries. They also apply to various types of boards: supervisory and management boards such as those common in Germany, and unitary boards popular in the United States and the United Kingdom.

[6] Chambers, N. (2012): "Viewpoint – healthcare board governance," Journal of Health Organisation and Management," Vol. 26, No. 1, pp. 6-14.

Figure 3
Seven hallmarks of engaged boards



Source: Better Boards

Hallmark 1: Team composition

Engaged and effective boards are a complementary mixture of different business experiences, perspectives, personalities, and behavioral styles. They've shed the homogeneity that leads to groupthink and reinforces shared biases. Adequate for simpler times, socially insular boards lack the versatility to handle complex new challenges. But our research confirms that diversity should go beyond adding women or minority group members to the board. Equally important is diversity of professional experience, subject-matter expertise, and "role behaviors" that underpin boardroom dynamics (see sidebar: What's Your Role Behavior?).

What's Your Role Behavior?

Boards function best when individual directors fill a variety of distinct but important roles, based on how each member naturally behaves in group settings. Here are some common "role behaviors" on corporate boards:

Developer	Fosters positive board dynamics
Critical thinker	Vets ideas and proposals for feasibility
Organizer	Coordinates board activities; monitors timetables and results
Implementer	Drives board decisions through to execution
Controller	Controls and reports on implementation of plans
Networker	Maintains extensive relationships and uses them to advance corporate goals
Shaper	Sets goals and direction, influences behavior
Creative thinker	Brings new ideas to the board

Hallmark 2: Ability to use the strengths of all members

Boards perform better when they take full advantage of each member's distinct strengths and personality traits. That means each director must understand what he or she brings to the table, and how it fits in with the strengths and behavioral roles of all the others. Effective boards conduct exercises to discover the traits and talents of each director, a process that reveals capability gaps and helps determine which members should play leading roles in various board activities.

In our practice, we've seen how this process energizes a board and even spills over into management. Directors who know their unique capabilities and understand their specific roles show greater confidence in their decision-making and embrace change more readily. Boards that discern and capitalize on the strengths of each member execute strategy more effectively, and get better results from large-scale transformation programs.

Directors who know their unique capabilities show **greater confidence in their decision-making.**

Recently, we worked with a high-profile board that was frustrated by its inability to resolve repeated customer service failures that were generating bad publicity and hammering the company's stock. Try as they might, directors couldn't bring their world-class capabilities to bear in a meaningful way. We advised them to break down the challenges into discrete components and identify the board members who could help managers solve each separate problem.

Hallmark 3: Clarity of roles and responsibilities

Ill-defined roles and unclear responsibilities—all too common among today's boards—leave directors unprepared to act effectively and unable to ensure that strategy is translated into execution and value creation. An engaged and effective board assigns clear roles and responsibilities to every member, consistent with their distinctive strengths, abilities, and characteristics. A director with overseas business experience might take responsibility for overseeing a company's foreign operations, while a technologist might help management develop a digitization strategy.

Boards should reevaluate assignments regularly and revise or add roles as changing conditions dictate. Duties also change when members join or leave the board. For example, when a top-flight financial executive joined the board of a leading company, she was assigned to lead the audit committee. The previous audit chair, an experienced HR executive, took on a new role helping the company develop a new philosophy on restructuring.

Hallmark 4: Joint vision

Most boards will tell you they have a common strategic vision for the company. Ask each member to articulate that vision, however, and you'll likely get as many different versions as there are directors. Needless to say, a board that doesn't really agree on where it's going will have a hard time getting anywhere. In a recent assignment, we found that incompatible interpretations of strategic goals were preventing directors from reaching agreement on certain important issues.

Effective boards allow no such strategic ambiguity. They agree explicitly on a single vision, and spell it out clearly enough to guide board decisions and spur directors to action. They make sure the vision is understood not only by all board members but also by managers at least two levels down the organizational chart.

Hallmark 5: Ability to resolve conflicts between board and management

Conflicts inevitably arise between corporate boards and the management teams they oversee. Often these conflicts erupt during a crisis—a strike by company workers, perhaps—that calls for a rapid, unified response. If board and management can't coalesce quickly, the situation may spiral out of control. Effective boards establish ground rules and mechanisms for resolving conflicts with management. Often, they designate a director with relevant expertise to work directly with executives in times of conflict.

Effective boards establish ground rules and mechanisms for **resolving conflicts with management.**

Consider the case of a large company hit by a strike that interrupted deliveries and angered customers who relied on the company for daily service delivery. After the labor impasse had dragged on for several months, two directors with proven conflict resolution skills began working with management to find a solution. Within weeks, a settlement was on the table.

Hallmark 6: Structure and organization of the work

Well-designed organizational structures and working processes enable boards to act efficiently and effectively, while poor structures and processes can lead to paralysis. Engaged boards understand that organizational effectiveness starts with a smooth operating relationship between the company secretary, the board chairman, and the CEO. They lay out a detailed road map for the year, a clear agenda for each meeting, and ground rules for boardroom interactions. They also schedule board work and meetings in a thoughtful way, aligned with the strategy and challenges facing the organization.

Hallmark 7: Regular reviews and reflection about the work

Simply adopting a new set of operating principles won't assure consistently superior board performance over the long term. Engaged boards take stock of themselves on a regular basis, scheduling formal sessions to measure their own performance against agreed-upon goals and benchmarks. They discuss what works and what doesn't, and consider new ways of improving their performance. Equally important are informal gatherings, where board members can connect on a personal level and gain perspective on their work (see sidebar: A Five-Step Action Plan for Better Boards on page 7).

A Five-Step Action Plan for Better Boards

Step 1. Integrate board development programs into broader corporate strategy and value creation processes.

Successful board audits and board development initiatives start with an in-depth understanding of the company's strategy and value creation plans. These broader imperatives guide a fit-for-purpose board design tailored to company goals. In working with clients, we have seen first-hand how integrating board development with company-wide transformation and strategic execution programs can accelerate change and deliver greater value.

Step 2: Get the evidence.

Evidence-based governance models require data, and lots of it. Board development programs that don't gather enough data on the issues most pertinent to effective governance tend to create structures and processes that don't improve performance. Successful transformations, by contrast, collect all the relevant data needed to build engaged and effective boards that achieve results.

Step 3: Provide directors with real insight.

Directors are time-pressed executives with little patience for undifferentiated, time-consuming data collection and abstract analysis. Board-development programs engage their attention and win their support by distilling evidence down to key data points that lead to concrete, specific, and actionable insights relevant to the role of each director.

Step 4: Give individual feedback in a neutral and confidential environment.

Board members appreciate confidential feedback on their own performance and the board's overall effectiveness. A frank, confidential, and neutral exchange helps directors reflect on how they can add greater value and strengthen the board as a whole.

Step 5: Keep gathering data.

An ongoing data collection mechanism enables a board to track progress and evolving patterns over time. This longitudinal insight forms a foundation for continuous learning by directors and senior management.

An Engaged Board is an Effective Board

Boards can't solve today's problems with yesterday's principles, processes, and attitudes. Too many still rely on outdated governance models that undermine their efforts to create value at a time of accelerating change and proliferating demands. They need a new approach rooted in evidence and tailored to the challenges facing boards today. The engagement theory of governance points the way to a model that fosters insight, agility, and confidence in decision-making. Grounded in research and proven in practice around the world, this approach melds the art and science of governance to drive significant improvements in board performance, whether implemented separately or as part of a broader transformation program.

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About A.T. Kearney

A.T. Kearney is a leading global management consulting firm with offices in more than 40 countries. Since 1926, we have been trusted advisors to the world's foremost organizations. A.T. Kearney is a partner-owned firm, committed to helping clients achieve immediate impact and growing advantage on their most mission-critical issues. For more information, visit www.atkearney.com.

About Better Boards

Better Boards is an independent consultancy specialised in developing executive and governing boards and executives that work with boards and/or aspire to a board position.

Better Boards uses for all its services—onboarding, board audit, and board retreats—innovative, evidence-based, bespoke solutions. Our approach is proven, efficient, and rigorous. It allows for business continuity without disruption, providing insights as well as practical and actionable solutions for the individual board members and the collective board.

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