FEATURE ARTICLE

Governance Checklists to ensure that Boards can **Partner with Management**

*Prof. Michael Useem

Though top management drives an enterprise's strategy and leader - ship, the governing board can also play a high-stakes role in both, and company directors are increasingly called to partner with executives for doing so. Fortunately, many non-executive directors come with extensive experience in running their own enterprises and are thus more than ready to contribute to a firm's strategy and leadership. The challenge is for them to bring that expertise regularly and systematically into their boardrooms – and for this, a set of governance checklists can prove an invaluable resource.

Governance checklists are akin to professional checklists found in many arenas, where they have long served as forceful guidelines for attention and action in high-performance endeavors. Aircraft pilots for flights from New Delhi to New York, for instance, must review a detailed pre-flight checklist before takeoff, requiring the pilots to reconfirm their flight plans, fuel supplies, and weather forecasts. Similarly, orthopedic surgeons at many medical centers must go through a pre-operative checklist, obliging them to reconfirm a patient's identity, scheduled procedure, and planned anesthesia before commencing the surgery.

Professional checklists imply that each of their itemized actions is mission critical for the user – and also that all of the mission-critical actions for the user are on the list. A failure to address any single action on the list – such as checking aircraft fuel or patient identity – can thus cause catastrophic failure even if all the other actions have been followed. Users' reconfirmation of all the checklist items thus helps assure a safe flight or successful surgery.

The checklist concept has been extended to company leaders as well, where mission-critical actions include thinking strategically, communicating persuasively, and acting decisively. We suggest here that the same should be extended now to company governance, resulting in a set of mission-critical checklists for methodically engaging directors in a company's strategy and leadership along with the executives.

We begin with a governance checklist for all parties – whether directors, executives, chairs, owners, or investors

– with questions they would be wise to raise annually or even more often when building, guiding, and appraising their firm's governance:

Governance Checklist 1: Questions for Directors and Executives

- Do company executives and directors have a compelling strategy for creating value and increasing advantage?
- Are company executives and directors capable of thinking and acting strategically?
- Is the firm's organization capable of executing its strategy?
- Do all executives and directors add value to the company's strategy and leadership?

The ability of a governing board to partner with top management also depends much upon the leadership skills of the board chair, whether independent or fused with the chief executive. Either way, here is a two-part checklist based on studies of board leadership in China, India, the U.S. and elsewhere for selecting a new chair for the board. It references a prospective chair's personal and professional qualities, and it is intended to guide the thinking of an outgoing chair, the chief executive, other directors, and the board's governance committee:

Governance Checklist 2: Criteria for Selecting a New Board Chair Personal Capabilities

- Extensive business leadership experience, including crisis leadership
- Respect and confidence of other directors
- Collaborative and restrained in style
- Personally bonded with other directors
- Comfortable in own skin and station in life
- Resilient, with a drive to confront and surmount setbacks
- Complete candor and expectation of the same in others

Professional Qualities

- An experienced mentor of business leadership in others
- Shows mastery of the company's central idea, strategy, and operating issues, and applies seasoned and judicious judgment
- Downplays self-interest and serves as a trusted counselor and partner of the CEO
- Displays a passion for corporate governance, including both monitoring and leadership
- Brings the personal time and emotional energy to devote to board leadership
- Listens well and draws out ideas, learns what other directors have on their minds, crystalizes directors' diverse views, facilitates expression of underlying concerns, and focuses deliberations
- Displays effective influence, corporate diplomacy, and constructive guid ance
- Embodies integrity and expects it in all directors and executives

For considering and interviewing candidates to join a governing board, including as chair, here is a question checklist based on the suggestions by a prominent American attorney who has consulted with many boards:

Governance Checklist 3: Questions for Interviewing Board Candidates

- There are times when executives, owners, or governance watchdogs may try to exert pressure on directors for a certain outcome. If so, how did you or will you react in the boardroom?
- Have you ever served on a board where some directors were not, in your opinion, doing what was in the best interests of the corporation as a whole? What did you do?
- Tell me about a time when you strongly disagreed with another director about your firm's strategy or company leadership, and how the issues were resolved.
- How would you handle a situation where there is pressure to achieve short-term quarterly results at the risk of jeopardizing the firm's long term company performance?

Governing boards, like company management, are ever evolving in their own internal priorities and external demands upon them, and here for illustration is a checklist for directors and executives of U.S. firms to consider in 2021, appreciating that the priorities on such a list are different from those of past years, and are also sure to change in the years ahead and to differ for directors and executives in India and elsewhere. Whatever the specific year-by-year or country-by-country items on the list, the main point is to make the identified priorities and demands in a given year and country salient when recruiting new directors and setting board agendas in a given year or national setting.

Governance Checklist 4: Contemporary Issues for Directors and Executives in the U.S.

- Board performance takes center stage. Many boards are giving ever more attention to strengthening their own performance and responding to shortcomings identified in their annual self assessments.
- Board composition is scrutinized.

Board composition is under pressure to meet new business challenges and stakeholder expectations. Today's directors are more focused than ever on ensuring their boards have the right expertise and experience to be effective.

- Board diversity gets attention. Stakeholders are more interested in board diversity, equity, and inclusion, and boards are increasingly focused on recruiting directors with a range of backgrounds and experience.
- More pressure on board priorities and practices. Director priorities and performance continue to face scrutiny from owners, regulators, and other stakeholders, causing board practices to remain in the public spotlight.
- Directors are more concerned about public health risks. Directors are actively working with executives to guide the company through the Covid-19 crisis and come back from it.

In collaboration with the top manage - ment team, governing boards are also becoming more directly involved in overseeing firm risk and resilience, and here is a governance checklist for directors for both:

Governance Checklist 5: Risk and Resilience Issues for Directors

- Directors are taking a more deliberative role in overseeing risk, helping to guide executives in managing the firm's risk appetite, risk tolerance, and risk readiness.
- Directors carry special responsibility for identifying hazards that can become disruptive or even disastrous if not detected and mitigated – including those caused by management.
- Directors can work with executives to caution against intuitive thinking that can lead company executives to misestimate high-impact but low probability risks, and to bring more deliberative thinking in to both the boardroom and executive suite.
- Recruiting directors with prior risk management experience as an executive or director of another company onto to a company's board can strengthen the firm's engaged and deliberative oversight of risk.
- Directors can usefully guide and appraise company risks in the development of new products and services, posing critical questions and challenging executive assumptions.
- Directors can play a special role in pressing executives to substantiate their forecasts, anticipated results, and identified risks without micromanaging them.
- Board chairs can more pro-actively involve directors in substantive dialogue by strengthening the norms of informed and active engagement in risk oversight.
- Company directors can also recruit and coach their top executives to think more deliberatively about company threats.

Since company owners and investors come with their own sets of distinctive concerns, here is a final governance checklist for their consideration:

Governance Checklist 6: Questions for Owners and Investors

- Has the board picked the right board chair and established a procedure to identify the next?
- Does the chair conduct effective executive sessions and make sure that the chief executive is receiving true feedback from the directors?
- Is the chair able to work well with top executives—but also ready to ensure that a faltering CEO is either mentored or removed?
- Has the chair arranged a way for directors to communicate directly with owners and investors?
- Does the board annually evaluate the performance of the chair?
- Has the chair arranged for the best prepared directors to serve as chairs of the key committees?
- Does the chair regularly consult off line with the other directors?
- Is the chair focusing the directors on the company's strategic challenges and leadership capabilities?
- Are the directors actively leading the company on key decisions in partnership with the executives, not just monitoring them?

Case Study

To illustrate how these checklists can be applied, we turn briefly to the world's largest personal-computer company, China's Lenovo Group, as it globalized its operations. We witness directors playing a central role in defining company strategy, leadership, and their integration for the company's globali - zation.

Founded in 1984, Lenovo emerged as China's largest computer maker, but “in our world,” explained Chief Executive Yang Yuanqing, “a high growth rate is hard to sustain if you only try to maintain your position in the China market.” In response, Lenovo acquired IBM's personal computing division, and in doing so, actively embraced the four questions in Checklist 1 to strengthen the strategic thinking and leadership of its directors and executives. On the first question, for instance—are all board members and senior executives adding value to the company's strategy? – the company revamped its board's membership and procedures to strengthen the directors' multinational contributions. On the second question –

is the post-acquisition governing board and top team prepared to think and act strategically in presiding over their firm? – Lenovo expanded its directors' attention to include a focus on the strategy and leadership of the company's multinational operation.

During the year before Lenovo acquired IBM's personal computer division, Lenovo's non-independent directors outnumbered independent directors four to three. Its post-acquisition board, by contrast, was divided among five executive directors, three private equity directors, and three independent directors. Prior to the acquisition, all seven of the directors were Chinese or of Chinese origin. After the acquisition, four of the eleven directors were Americans. Before the acquisition, board meetings had always been conducted in Chinese, but afterward English became the medium. Going into the acquisition, the executive chairman and chief executive were both Chinese; coming out of the acquisition, the executive chairman was Chinese and the CEO American. Ma Xuezheng, the company's CFO at the time of the acquisition, explained: “This is going to be very much an international company operated in an international fashion.” And that now carried into the boardroom. Lenovo non-executive director Shan Weijian added, “We don't want people to have a feeling of takeover [by a] Chinese company of the American company. We want an integration process [that] doesn't involve which part takes which.”

After the acquisition, Lenovo's directors pressed for bringing new directors onto the board who would add deep experience to the firm's strategy and corporate leadership. The selection standards for new board members, reported Yang, now came to include both executive experience and strategic vision. For one board seat, for instance, the company vetted more than 20 candidates, narrowed the list to four finalists, and finally invited John Barter, who had served as AlliedSignal's chief financial officer and president of its 35,000-employee automotive division. He became the final choice because of his proven experience in leading a large profit-and-loss company division.

In the wake of the IBM PC acquisition, Lenovo moved its directors from a relatively limited role in monitoring management to more active engagement in the company's strategy and leadership. “The IBM PC acquisition is a watershed,” reported Lenovo founder and executive chair Liu Chuanzhi. “Before that point,” he said, “the board of directors did not play much [of a role].” The board had been primarily concerned with audit and compensation, but after the acquisition, it would come to play far more of a role.

The strengthening of the Lenovo board brought directors into direct guidance of the integration strategy for merging Lenovo's and IBM's distinct operating styles. IBM had built a business model around strong enduring relations with select corporate customers; Lenovo by contrast had created a more transactional model with many retail customers. Although large-enterprise relationships had been the staple of IBM's PC sales, Lenovo management anticipated greater global growth on the retail side, and it sought strategic guidance from the company's reconstituted board on optimal opportunities for building that model abroad.

To ensure a disciplined alignment of strategy and leadership, Lenovo formed a board-designated strategy committee, charged with vetting the company's mid- and long-term decisions on behalf of the directors. It included two Chinese executive directors – Yang Yuanqing and Liu Chuanzhi – and two American non-executive directors – James Coulter, a founding partner of the private equity firm Texas Pacific Group (TPG), and William Grabe, a managing director of private equity firm General Atlantic (GA).

The Lenovo board met quarterly, but the strategy committee met monthly on issues ranging from company direction to cultural integration. The committee served as an “impartial third party,” reported executive chair Yang, to help prevent a “confrontation” between the Chinese- and American-heritage divisions of the company. In the experience of CEO William Amelio, the directors worked with him and the other executives to pick from an array of choices “the right idea that is going to maximize the core competence of the company.”

The Lenovo directors also became directly engaged in decisions on executive succession – the key choices on the company's leadership, an arena that had not been the board's prerogative before the IBM PC acquisition. The two independent directors from the private equity groups – Coulter and Grabe – played a pivotal role, for instance, in the early replacement of the first CEO after the IBM acquisition. At the time of the transaction, IBM's Stephen Ward had seemed the logical candidate for the role of chief executive, with Yang to serve as executive chairman, but within several months it was evident to the board's strategy committee that Ward's leadership was not a good fit with the firm's new direction. Supply chain efficiencies were going to be critical to ensure the profitability of the combined companies, but the first CEO did not come with the requisite experience for optimizing those efficiencies in an extremely cost-conscious market.

In applying the second question in Checklist 1 on whether top executives are capable of thinking and action strategically, the board pressed for Lenovo's officers to reflect the new geographies where the company now operated. Of the top management team in 2004, a year before the acquisition, all were Chinese; of the 18 members of the top management team in 2007, two years after the purchase, six were from greater China, one from Europe, and 11 from the United States.

In line with part of the fourth question in Checklist 1 – do all directors add value to Lenovo's strategy and leadership? – Lenovo made a point to bring a host of strategic issues to the board for its vetting and final decision-making. The issues included how long to retain the IBM logo on its products – the acquisition agreement had allowed for five years – what new acquisitions to pursue, which adjacent product areas to enter, and whether to build devices that bridge laptops and desktops. The strategy committee in particular went "through all the options and thoroughly [vets] the pros and cons of the various courses of action," reported CEO Amelio. The two American directors from the private equity firms brought extensive experience in acquisitions and that made them particularly valuable for appraising prospective decisions, in the experience of Amelio. They were "totally invaluable," he said, "because the name of their game is lots of acquisitions and mergers."

When Lenovo executives considered acquiring another personal computer maker, the strategy committee and even the full board became actively engaged on whether to proceed and if so what to pay. "Everybody was involved," reported non-executive Shan Weijian, "because this is a large issue for the entire company." Lenovo decided to back off, guided by the board's skepticism about the deal's potential value.

The board's strategy committee also played a particularly important role in appraising the company's leadership. The executive chair and chief executive submitted annual self-assessments and 360-degree feedback results to the committee and the board, and the directors then evaluated the extent to which the executives had achieved their annual plan's financial, market-share, talent recruitment, and related goals.

In line with the several governance checklists proposed here, we saw a sharp divide between the way the Lenovo board operated before and after its decision to build out globally with the IBM PC division acquisition. Prior to the purchase, the board had operated without a strategy committee or an annual performance review. Now it had both. Director decisions before had been largely limited to accounting audit and shareholder rights. Now their decisions ranged from branding to sourcing, and more generally from strategy to leadership.

Directors thus played a far larger role in company strategy and leadership in the wake of the IBM acquisition. They had replaced the first chief executive, decided against an acquisition, and facilitated cross-cultural integration of widely different divisions. A decade after the IBM PC acquisition and remake of its board and management to better strategize and lead the company, Lenovo's global market share of PC sales had become the largest of all competitors.

Conclusion

In sum, to draw the best from a governing board, developing a set of governance checklists is a way to help ensure both directors and executives are attentive in detail to the mission-critical features of what makes for an optimal combination of strategy and leadership in your boardrooms. ■

Prof. Michael Useem is Professor of Management and Director of the Leadership Center and McNulty Leadership Program at the Wharton School, University of Pennsylvania, USA.