Perspectives

Making Sure Independent Doesn’t Mean Ignorant

The Boston Consulting Group
Making Sure *Independent* Doesn’t Mean *Ignorant*

Whatever the final outcome of the current wave of corporate reform, one thing is clear: corporate boards will be seeing many more independent directors. The New York Stock Exchange, for example, recently approved recommendations mandating that a majority of a company’s directors have “no material relationship” with the company, and that these independent directors meet regularly without the CEO.

It’s hard to argue with independence as a value. After all, boards exist to oversee management and to make sure the company is run in the interests of its shareholders. But a big question remains: Will independent board members have enough knowledge of the companies they are governing to be effective?

Outsiders who are genuinely independent find themselves at an enormous information disadvantage. Paradoxically, the more independent the board, the more it must rely on management for information about the business. In a worldwide survey of CEOs’ attitudes about their boards, we found that less than half the CEOs were confident that indepen-
dent directors really understood the factors driving performance in their business. Little wonder when you consider that the average U.S. director spends only about 100 hours per year on the job. (European directors spend even less time.)

So how to ensure that independent doesn’t just mean ignorant? Consider the following six recommendations.

**Widen the talent pool for directors.** To begin with, widen the talent pool of candidates and seek more diverse skills. The most important determinant of a board’s effectiveness is the quality of its directors. In addition to the attributes that everybody is talking about—integrity, accountability, and sound commercial judgment—a good director must also have the intellectual capacity to dig deep into the details of an unfamiliar business.

Furthermore, instead of just considering current or former CEOs (the typical approach at many companies), think in terms of filling specific slots or functions. A few directors should be chosen with the explicit goal, to put it bluntly, of keeping everybody out of trouble—someone who really understands financial numbers, obviously, or someone with operating experience in areas of major environmental or financial risk. Others should have in-depth knowledge about specific challenges to the company’s main busi-
nesses. And at least one board member should possess broad strategy skills.

**Design processes that build understanding.**

Too much time at board meetings is spent listening to formal presentations and “ticking” procedural boxes, and not enough time engaging in the substantive issues affecting the business. Instead, think of board activities as vehicles for directors to learn about the business. For example, board meetings should have at least half of their time allocated to a discussion of major issues affecting the company’s future. And business unit heads, not the CEO, should report on financial results. That way, directors can get valuable exposure to the broader management team.

It’s also important to encourage directors to spend more time outside the boardroom. Our experience suggests that nonexecutive directors spend the vast majority of the time they devote to their task—roughly 90 percent—either alone reading their board papers or seated around an impressively large table with other directors. They spend hardly any time meeting with line managers, visiting plants or key customers, or talking to industry experts about competitors or overseas trends. So give new directors a license to travel around the business. It’s a great way for them to learn what is really going on.
Develop specialist expertise. Most directors see themselves as generalists. Because they are liable for everything, they reason, they need to be involved in everything. To the degree that board roles have become specialized, this specialization has usually been limited to issues of conformance—for example, the work of audit committees or environment committees—and not performance.

That is a mistake. Individual directors should be encouraged to develop more specialized knowledge in a couple of areas important to the company. Be prepared to establish temporary subcommittees to explore critical questions in greater depth. For example, if major investment in Eastern Europe is a priority across the portfolio, assign one or two directors to learn about the experiences of other companies investing there. These directors should create a personal network of experienced contacts and talk occasionally to consultants and peers involved in the region. Going deeply into one area does more than build specialist expertise: directors will learn more about the business at large while exploring a narrow slice of it.

Encourage constructive dissent. Even when independent directors are knowledgeable about the business, they may feel inhibited about expressing their views lest they go against perceived consensus. An effective
board, however, whether supports and challenges management. Boards can encourage constructive dissent by designing it into their process. For example, on contentious matters, assign one board member to be a "designated critic" in order to foster legitimate dissent and debate without creating the ill feeling that can arise if a director asks too many questions. Or set up a due-diligence committee with the freedom to probe an important issue.

**Match the time to the task.** For all the recent attention paid to corporate governance and board performance, remarkably little has been given to the question of how boards can possibly do their job in the time they spend on it. All these changes will require directors to devote far more time to the job than they have in the past. The typical 100 hours per year is the bare minimum. If a board genuinely intends to monitor company performance and discuss major strategy issues, then directors need to commit time far beyond the current norm.

**Don’t make a fetish of independence.** A good board must have the capacity for independence. But that doesn’t mean that every director needs to be independent, in the strict sense of having absolutely no material relationship with the company. It can be a great advantage to have one or two directors who know a lot about the business, even if in some
respects they are conflicted. It will be necessary, of course, to make sure their position is clearly understood and to develop protocols to deal with it. But tolerance for a small amount of conflict can pay dividends in terms of expert advice and understanding. As one chairman told us: “The most useful director on our board has a conflict of interest. But if management wants serious advice, that’s who they go to.”

The challenge facing public companies will be to reinforce independence without sacrificing expertise. The effectiveness of their boards will be determined by how well they strike that balance.

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