The Value of a Non-Executive Chairman

“Appointing a Non-Executive Chairman is the single most effective step a Board of Directors can take to force sweeping change in governance – a proven drive of higher market value.”
The Value of a Non-Executive Chairman

The Governance Environment for The Board of Directors

Performance Expectations are drastically changed
- The scope of Board involvement has grown.
- Boards must strengthen oversight and, for the first time, begin actively monitoring business plan execution.
- Board accountability today is both individual and collective.
- Board qualifications and commitment must change.

The Old paradigm for Board organization is inadequate
- There is tangible evidence that good governance increases shareholder value.
- Dramatic changes have occurred in the legal and accounting compliance environment.
- These changes place new pressures on Boards, beyond their traditional legal and fiduciary responsibilities, to include compliance and active involvement in ensuring that strategies are executed.
- Boards must be creative and aggressive in driving rapid change to meet their expanded accountability.
- Even among privately-held, rapid-growth companies, competitive pressures and the complexities of managing growth to liquidity often dictate having an independent Chairman as advisor to the CEO and representative of minority shareholder.

The inescapable conclusions . . .
- Accountability for performance starts at the top.
- Boards must move to having an independent Chairman.
- One person can no longer effectively fulfill the responsibilities imposed on the CEO and the Chairman.
- Appointing a “Non-Executive Chairman of the Board” is the single most decisive step that a Board can take to force systemic and truly effective change in corporate governance.
A Non-executive Chairman – the crucial difference

The traditional role of Board Chairman is not adequate to meet the expanding accountability faced by Boards of both public and private companies. Often the positions of CEO and Chairman are combined – creating irreconcilable conflicts – or the role of Chairman becomes largely symbolic in actual practice. Events of the past few years crystallize the need for drastic change in organization and practice.

Traditional roles
While all Boards function differently, with many being active in daily operations, generally the following roles have evolved:

**The CEO** formulates and executes the business strategy under plans approved by the Board.

**The Board** exercises legal and financial oversight and review of financial results but with little emphasis on monitoring management or how the business plan is being executed.

**The Chairman of the Board** sets the agenda for the Board, oversees the CEO and management on behalf of the Board.

A new position, **Non-Executive Chairman of the Board**, can become a new driver of systemic change, ensuring that the Board properly executes its expanded responsibilities – to challenge management, to oversee more complex compliance and to monitor execution of the business plan.

The Non-executive Chairman can play a critical role in representing the different constituencies in the company with an impartial viewpoint. The Chairman enhances independence of the other Directors and ensures that all voices have a fair hearing; helps maintain continuity during times of management change; is a voice “above the fray”; can play an effective role as mediator and can assist the CEO with difficult public relations issues.

How does a Non-executive Chairman function?

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<thead>
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<th>A new approach . . . expanded accountability</th>
<th>Traditional Board Chairman</th>
<th>The Non-Executive Chairman</th>
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<tr>
<td>Reviews and approves operating plans</td>
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<td>Reviews financial &amp; operating results</td>
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<td>Sets Board agenda</td>
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<td>Makes Board committee assignments</td>
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<td>Recruits new directors</td>
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<td>Oversees CEO &amp; management – high-level</td>
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<td>Participates on all Board committees</td>
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<td>X</td>
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<td>Monitors business plan execution in-depth</td>
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<td>Oversees &amp; reviews CEO in-depth</td>
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<td>Oversees management in-depth</td>
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<td>Participates actively and regularly in operations</td>
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<td>Liaises actively with Board and management</td>
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<td>Coaches and advises CEO &amp; top management</td>
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<td>Works actively in business 2x days or so per week</td>
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A CEO’s view . . .

“The investors suggested and we agreed that the roles of Chairman and CEO should be separate. As CEO I wanted a Chairman who would actively assist in growing the business while assuring the Board as to internal process. Having a Non-executive Chairman available real-time to participate in the business brought invaluable experience and perspective and strengthened our market presence overall. The Non-Executive Chairman’s breadth and depth of operating experience was critical to our market entry.”

Alex Smith, Former CEO, Vellis Knowledge, Inc

Pressures on the Board of Directors

Board role
There has been a dramatic new focus on the role of the Board of Directors in the “Post-Enron” era. While the focus of rulemaking has been on public company Boards, private company Boards have similar accountability and in some ways broader challenges.

Operating framework
Any Board operates within a framework that requires balancing of conflicting demands:
- Legal and fiduciary obligations.
- Effective operations oversight.
- Stakeholder accountability and responsibility.
- Providing management guidance and support.
- Monitoring and ensuring business plan execution.

A delicate balancing Act
This is a delicate balancing act in any company – made more complicated and time-consuming in a private or venture-backed company with myriad growth pressures and the often-continuing need to mentor management as well as monitor execution.

Increasingly there is appropriate pressure on the Board to:
- Separate the roles of Chairman and CEO.
- Ensure appointment of an active Chairman.
- Guarantee that legal and policy guidelines are met in a rapid growth environment while ensuring business plan achievement.

The market value of good governance

The problem is extensive
While most publicized examples of weak governance have been among public companies, the Boards of private companies cannot afford to ignore their similar, yet more comprehensive, obligations. The time to ensure proper governance is today.
Investor surveys show the value
McKinsey and Company has done extensive survey work to document the market value of good governance. Their research since 1996 shows that good governance pays:

- In 1996, major investors said they would pay, on average, a 16% premium for good governance.
- In 1999, major institutional investors said they would pay an 18% premium for the shares of well-governed companies in the US or UK.

Weak governance increases shareholder risk
Poor governance increases risk at best and is penalized at worst. On the flip side, strong governance reduces the company’s cost of capital, improves competitive performance and increases shareholder value. Thus the imperative for the Board to impose strong governance today is transformed from a simple legal requirement to an affirmative fiduciary obligation to stakeholders.

The trends are telling
The Spencer Stuart surveys of trends in board governance support the move to independent Chairmen. In their 2006 survey of S&P 500 companies they note that the role of Board Chairman and CEO are combined on 67% of boards, from 74% five years earlier. However, they note resistance to true independence and only 10% of boards have a Chairman who is an outsider. Many boards appoint a lead or presiding director in lieu of separating the roles of CEO and Chairman.

The basics of good governance
The criteria for good governance now include such basics as:

- Transparency in information exchange with outside parties.
- A majority of outside and independent directors.
- Formal and regular evaluation of management by the Board.
- Independent audit, compensation and other critical committees.

The Board must go beyond the basics
Yet Boards can no longer be reactive. They have affirmative obligations for governance that require new and creative action. They must go beyond the simple basics and find ways to drive good governance throughout the organization. This requires hands-on involvement going beyond the simple oversight of yesterday.

The starting point for good governance is proper organization, including the appointment of an effective and experienced Non-Executive Chairman to oversee and manage the process of conversion to a truly independent and well-functioning Board.

How do you select a Non-executive Chairman?
In the past . . .
Historically, the position of Board Chair has been filled either by the CEO or by some other experienced, high-level, outside executive – often
with many other corporate Board or Chair responsibilities – whose time is spent interacting with the CEO. Often it is felt that only candidates from within the industry can be effective. Historically CEO’s have been very reluctant to give up one of their titles either out of fear about how governance would evolve or for reasons of ego.

What has become clear is that in order to make the separation work well it is critical to have absolute clarity about respective roles and responsibilities and to have that agreement made clear to the board and to the company at large.

Today . . .
The Non-Executive Chairman for today’s private company has a set of skills significantly different from the past – generally with the following profile:

- Broad operating experience across many industries.
- Deep management experience – both high and low level.
- Operating experience across business – sales, finance, operations.
- Entrepreneurial experience – preferably starting several companies.
- A strong understanding of legal, accounting and financial issues.
- Specific industry experience only where the industry requires detailed regulatory, finance or other management expertise.
- Demonstrated high integrity.
- Experience coaching or advising CEO’s and senior management.

The bottom line
The traditional role of the Chairman – for most Board Chairmen often only one of the many such Board positions they hold – must be transformed to that of a full or part-time position. The new Non-Executive Chairman will have far fewer outside responsibilities than is customary today. The Executive Chairman will be the point of the fulcrum for balancing Board accountabilities.

The Non-Executive Chairman maintains the balance