What Do We Know About Boards?

MY PERSPECTIVE SERIES:
REPRESENTING THE AUTHOR'S PERSONAL PERSPECTIVE

Boards need to have members who bring a mix of competencies, life experience, diverse backgrounds and strategic thinking.

by Louis L. Marines

New business and market pressures are changing corporate governance within the design professions. The days when an engineering or architecture firm could treat its board as, to quote a colleague, "a glorified executive committee" are gone. The contemporary board of directors must take an active role in the firm's well-being and future, ensure business continuity, oversee strategy and set high standards, both within the firm and in the public eye.

What makes for a successful board of directors? The common temptation — and one found in thousands of articles — is to try to quantify a specific formula: a number of people based on company size, an exact mix of capabilities, a ratio of inside to outside directors and the like. Professor David Larcker of The Stanford Graduate School of Business reports in his "Closer Look" series on corporate governance that numerous studies have shown that the quality of any given board of directors is not determined by such factors. Instead, he says that "board quality likely depends on attributes that are less well examined, including the qualification and engagement of individual directors, boardroom dynamics and the processes by which the board fulfills its duties ... the most destructive myth in corporate governance is the notion that best practices exist which, if uniformly followed,

lead to better oversight and performance. This is simply not the case."[1] Larcker goes on to point out that corporate governance is such a complex activity, that it is unrealistic to expect it to be reducible to a "recipe in a cookbook."

BOARDS ARE NOT MANAGEMENT

Engineers and architects are highly trained to solve complex problems for clients and society. They have not usually had much, if any, business training. Yet many firms have boards of directors that are made up primarily of the firm's own executive committee. David Evans, chairman emeritus of David Evans and Associates, Inc., in Portland, Ore., said, "I have been on many boards of other firms and have often seen a large number of company managers on the board. These boards tend to be caught up in operational questions. The board is different from the executive committee, and running it like one is a mistake. You need people who know more about business than you do, and they should be very focused on protecting the value of the firm for the shareholders."

Too many internal managers on the board also hamper its function of overseeing and supporting the CEO — who is the CEO to turn to when faced with a challenge outside his or her experience, or capacity to solve?

Having outside board members who have a depth of experience in business, preferably from beyond the engineering and architecture world, can bring the firm a greater capacity. Their focus on protecting the shareholders' interests and the overall health of the firm should provide a higher and wiser level of guidance.

BOARDS NEED DIVERSITY

Many boards at professional design firms show almost no diversity in their makeup, even though the diversity of staff at engineering and architecture firms has increased over the past 20 years.

Debra Rubin at Engineering News-Record (ENR) reported in November 2010 that a 2007 study of Forbes 500 firms by Catalyst LLC found that "companies with at least three women on their boards outperformed those with fewer female directors in return on equity (53%), return on sales (42%) and return on invested capital (66%)." These figures certainly demand attention.

David Evans says, "We always have a woman on the board from inside the firm and when we rotate our inside directors every few years we make sure one of them is a woman. We have not yet had an outside director who is a woman, but we are looking. We need and value a variety of perspectives — we don't want a board with people who all have the exact same outlook."

Another aspect of diversity is in response to globalization. Strategy + Business revealed in its special report "CEO Succession 2010" that "more than one-quarter of the top 2,500 public companies now have their headquarters in emerging countries," including not only the expected Brazil, Russia, India and China, but also countries generally not reported on as being economic hot spots: Egypt, Bangladesh, Turkey, South Korea, Vietnam, Nigeria, Mexico and others. As design and construction activity grows in these locations, our firms will want to be there — and having people on the board who understand the countries your firm chooses to operate in will make a difference, not just internally, but in the eyes of clients and the local community your firm will be joining.

BOARDS NEED STRATEGIC THINKERS AND FORWARD LOOKERS

Boards need to have members who bring a mix of competencies, life experience, diverse backgrounds and strategic thinking. Oberman & Associates, Inc. of Irvine, Calif., reported in ENR in February 2011 that a survey of top executives of engineering, architecture, construction and related firms shows that "42% want directors who are strategic thinkers and forward-looking" and have strong financial skills. Experience as a CEO or executive manager was deemed of less value, rated as important by only 11% of the survey's respondents. Three quarters of them also said that "strategic growth" was a key board priority for the next two years.

This need to focus on the future and strategy is not new, but today may require a new set of outlooks and a different set of specialized competencies, for example, a deep knowledge of current and potential technological developments or a dedicated and active commitment to corporate social responsibility.

> **Boards need to have members who bring a mix of competencies, life experience, diverse backgrounds and strategic thinking.**

BOARDS — AND FIRMS — NEED A SUCCESSION PLAN IN PLACE

The board is responsible for ensuring the financial and business continuity of the firm. Yet numerous studies — from Stanford University, Booz & Company and many others, including a study conducted in 2007 here at FMI — show that only about 40% of firms, regardless of industry, have a CEO and other management successors in place and ready to take over, leaving some 60% of businesses vulnerable to sudden change. Firms that do have successors identified may not have told them and risk losing them. Others say their chosen successors need a level of development that would put the firm in the position of hiring from outside in the event of the CEO leaving suddenly. "Having talented, motivated employees ready to take the place of an owner who is prepared to step aside is the exception rather than the rule," said Landon Funston, FMI principal and author of the study.

"We all think we're immortal," David Evans said. "But I remember a firm in Oregon whose owner died unexpectedly in his 50s, and the firm was unable to survive — the successor tried to make a go of it, but wasn't ready. At DEA our board reviewed our succession plan and interviewed the candidates we had identified. Their first reaction was to joke that 'maybe you guys shouldn't plan on retiring so soon,' but they came to see the talent that we saw in the candidates and our seven-year development and transition process has gone very smoothly."

GREAT INTERPERSONAL SKILLS ARE KEY TO BOARD SUCCESS

Even if no magic recipe exists, we still may see many common dynamics at work in highly successful boards. Effective boards embrace relationship virtues such as civility, truth telling, the courage to embrace conflict, clarity about decision making, mutual respect and support.

"Our board members get along really well," said David Evans. "They are all focused on the same thing; they are civil when they disagree, but they can be blunt if they think the firm is going off the track. Their favorite mantra is 'strengthen your balance sheet.'"

The individual board members' skills at negotiating with others and asking powerful questions can be highly valuable assets. Members must be able to challenge each other, question assumptions and examine issues in ways that lead to creative thinking. But outright conflict that cannot be resolved is a distraction that interferes with decision making. In his study "Is Discord Detrimental?," Jason A. Grissom of the University of Missouri's Harry S. Truman School of Public Affairs has shown "a consistent pattern of negative associations between board conflict and outcomes at multiple organizational levels." Discord and conflict on the board result in less effective policies and can filter down to the management team, having a variety of negative impacts throughout the firm, from higher turnover to poorer financial performance.

In their 2005 book, "Inside the Boardroom," Richard Leblanc and James Gillies assert that the results of their comprehensive study of boards of directors show that "functional directors ranked high in their ability to persuade fellow directors to accept their point of view and worked constructively with their fellow directors in seeking effective decisions for perplexing problems ... these directors had in common a capacity to work with their fellow directors in hammering out, through give-and-take discussion, a decision that the majority of the board could support."

The art of putting a mix of board members together who can work well and will be committed to the benefit of the firm and its shareholders, as well as providing both oversight and support of the CEO, is not a quantifiable formula. Design firms would see strong business benefits from making a commitment to forming a board distinct from the executive operations of the firm, with a diversity of outside directors bringing their skills to the table, and with a mix of personalities and abilities that will work well together and help raise the firm to the next level. ■

***Louis L. Marines**, Hon. AIA, is the founder of the Advanced Management Institute for Architecture and Engineering, now the A/E Services Division of FMI Corporation. He consults with professional design firms across North America and is an active author and speaker. His book "The Language of Leadership," was published in 2010 by Greenway Communications. Marines is a CEO Emeritus of the American Institute of Architects in Washington, D.C. He can be contacted at loumarines@gmail.com.*

[1] Larcker, D., and Tayan, B. (2011). Seven Myths of Corporate Governance. Stanford Graduate School of Business Closer Look Series: Topics, Issues and Controversies in Corporate Governance CGRP-16. Retrieved on 8/7/11 from: http://www.stanford.edu/group/gsb_corpgov/cgi-bin/blog/?p=2045

LESSONS LEARNED

David Evans, chairman emeritus, founded David Evans and Associates Inc. and its parent company David Evans Enterprises Inc. in Portland, Ore., in 1976. DEA is an engineering, planning, architecture and consulting company that covers four core areas: transportation, energy, land development and water resources. It has 17 offices in seven states and employs more than 650 people.

FMI asked Mr. Evans his thoughts about the following:

Boards in consulting design firms

I have been on multiple boards and how the board functions has much to do with how the company sets itself up. Some design firms have a number of principals on the board, and they have difficulty separating board governance activities from running the company. This hurts them in the end, as the board needs to provide oversight on behalf of the shareholders — that is, looking at and advising on company performance, not managing the day-to-day operations. The board should not be the same people who are managing the firm.

The value of outside directors

When we first brought in outside directors, we had four from outside and three from within the firm. That really put the pressure on me as chair, because they could outvote me; so it changed my perspective on how to run a company. We know what engineering is all about, but we didn't study business in college, so we seek outside directors who can help us run a corporation instead of telling us how to be engineers. They pay attention to what is best for company performance. Several times they have said, "This potential acquisition is not a good idea," and we listened because they were looking out for the health of the firm.

Finding diverse board members

Over time we have had a former CFO from the wood products industry who is good at finance and business practices, the retired chairman of a bank, an ex-director from ODOT (Oregon Dept. of Transportation), a former colonel from the Corps of Engineers who was not actually an engineer, someone from the construction industry with a lot of design-build knowledge, a retired local businessman who ran his own company for many years, and the dean of structural engineering from a major university.

Unexpected consequences

When our former ODOT board member joined us, the first thing that happened was that ODOT cut us off. It perceived this as a conflict of interest and would not award us any work during his tenure, which unfortunately had to be a short one. We wanted to have someone who understood the client side, but the possible consequences had never occurred to us.

Biggest challenge his board solved

In the mid-1990s we were being affected by the downturn in telecom work, when our bank, Bank of America, was preparing for its merger with Nations Bank. It told us that we were not good enough to bring to a merger; it didn't want to show engineers on their books, so suddenly we were looking for a new bank. Our board members stepped up and helped find us a new bank, where we enjoy a much better relationship.

CONTACT THE *FMI QUARTERLY*

CUSTOMER SERVICE:

quarterly_info@fminet.com

SUBSCRIPTIONS:

1.800.877.1364

ARTICLE REPRINT PERMISSION:

919.785.9236

VISIT FMI ONLINE:

www.fminet.com