Eight Principles of Effective Governance

Effective Boards Need To Be in Place Long Before A Critical Decision Looms

BY BARRY S. BADER

Mr. Bader is President, Bader & Associates, Potomac, MD, which runs the website GreatBoards.com.

If your board of trustees vanished, would anyone notice?

If the top management team flew off to Tahiti for a year, organizational performance would undoubtedly suffer. Similarly, the departure of the most active physicians would visibly and negatively affect patient care.

But if no board or committee meetings were held for a year or two, what value would be lost? Would financial margins shrink without the finance committee's oversight? Would services to the poor be cut back without attention from the mission committee? How about clinical outcomes—would they deteriorate without board oversight of the quality of care and medical staff appointments? Without dedicated and influential trustees on the job, would community confidence in the ministry decline? Would the organization's relationships with the sponsors worsen?

The Value That Boards Add

A disappearing board may be fantasy, but these questions are not merely rhetorical. They are designed to stimulate thinking about how a governing board adds value to the organization and its mission.

In publicly owned corporations, "good boards expect to add value," writes corporate governance expert Ram Charan in his book *Boards at Work*. "Good boards accept as a given the notion of the value-adding board."[1]

Adding value is easier to define and measure in a private corporation than in a not-for-profit enterprise. The corporate board ensures that the organization is run in a manner that increases shareholder value, as measured primarily by the stock price. All the functions of governance—approving the strategic plan and annual budget, selecting and evaluating the CEO, monitoring financial performance and customer satisfaction—can be boiled down to a single indicator: Does the price of the stock increase over time?

The board of General Motors, writes Ram Charan, was instrumental in getting the company and its new CEO to focus on its weakness in marketing and to make other changes that resulted in a huge turnaround for the car maker in the 1990s.[2]

Late last year, the directors of Coca-Cola took the rare step of rejecting a strategic acquisition proposed by the CEO because they were unconvinced that anticipated actions would boost shareholder value.[3]

Perhaps Coca Cola's directors feared repeating the error of the Quaker Oats board, which approved the purchase of Snapple Beverages for $1.7 billion. Quaker could not make oatmeal and fruit juice mix and sold Snapple for a huge loss. Analysts roundly criticized Quaker's insider-dominated board for failing to question the purchase price and management's rosy projections.[4]

Like their corporate counterparts, boards of not-for-profit organizations are expected to add value to financial performance. Without a margin, there are no resources to meet the mission. Several high-profile failures point to the "value-added" that not-for-profits need from their boards.

In a modern version of Nero, the board of Allegheny Health Education and Research Foundation (AHERF) fiddled as a $2 billion health system burned cash until it went bankrupt with more than $1 billion in debt. The board failed to ask hard questions of its chief executive officer and board chief about AHERF's aggressive strategic expansion and risky financial decisions.[5]

The board of Eckerd College in St. Petersburg, FL, allowed the CEO and CFO to tap into the

endowment to cover operating deficits without board approval. In an 18-month period, assets fell from $34 million to $18 million. Fortunately, this board awakened from its nap, raised the funds needed to save the college, and revamped governance so the same mistake wouldn't happen again.[6]

These examples notwithstanding, success in not-for-profit organizations is measured not only in financial terms but also by fulfillment of the mission of service to key stakeholders. Patients, their families, the community, and especially the poor are among a hospital's stakeholders. So are its physicians and the employees who serve the external constituents. Other important constituents may include the business community and local government. No stock price judges the organization's value to its stakeholders. Instead, a not-for-profit's worth is a composite of clinical outcomes, customer satisfaction, and improved community health status as well as its financial and operating performance.

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TRADEMARKS OF EFFECTIVE NOT-FOR-PROFIT BOARDS

The effective corporate board knows its role is to add value. Similarly, the effective board of a not-for-profit Catholic health care organization understands that its work should enhance both the mission and the margin. Effective not-for-profit boards add value in at least four tangible ways.

Better High-Level Decisions. Effective boards are a forum where committed and knowledgeable trustees raise hard questions about proposed strategic business and financial transactions. Sounder decisions result, not because trustees are smarter than management, but because of the deliberative process itself. CEOs who expect sharp questioning by trustees savvy in business and finance do a better job educating their boards and preparing proposals to pass muster. When senior management and the board have discussions that resemble a graduate school seminar, the give and take has a synergistic effect, producing new insights and innovative ideas.

For example, the board of a Catholic health system on the East Coast turned down the proposed acquisition of another faith-based system at the eleventh hour. Led by trustees with strong financial and business knowledge, it instructed management to restructure the deal on a more sound financial footing, which it did. In retrospect, the CEO credits the board's courage with paving the way for an acquisition that is more likely to succeed.

Better Organizational Performance. Even the best-laid plans can succumb to unforeseen market forces and implementation problems. When a key initiative "heads south," CEOs often think they can fix the situation, so they sugarcoat less-than-stellar results. They worry that revealing too much to the board could be a career-limiting act. Yet, full disclosure is exactly what effective CEOs do when they can count on a constructive reaction from the board.

For example, one Catholic health system spent tens of millions of dollars acquiring physician practices to implement an integrated delivery system strategy, only to see losses reach the hundreds of millions. Ultimately, the CEO was fired. However, one trustee says the failure wasn't in the initial decision to acquire physician practices or even the high purchase prices it paid.

"Every expert in health care said at the time to buy doctors' practices," he recalls. That wasn't a board or management failure. The lapse started a year later when the board quietly accepted much higher than anticipated first-year losses. If the board had done a post-project analysis, the system could have taken corrective action much sooner rather than three years later. It wound up writing off millions of dollars as it dismantled its physician network. By contrast, the board and management of a hospital system in western New York acted quickly to renegotiate contract terms and institute productivity requirements that restored the practices' viability and kept the network intact and growing.

An effective board also improves performance by setting ambitious but realistic goals and monitoring performance. Boards that listen passively to management reports are not doing their job. Effective boards question, learn, and challenge the organization to continually excel.

Critical Connections. Not-for-profit boards add value by keeping the organization attuned and respon-

sive to the changing needs of its diverse constituencies. Sometimes trustees make tangible connections that support management's work. One hospital was being cut out of an important HMO contract because of the prior CEO's antagonism to managed care; the new CEO couldn't even get his phone calls returned. A trustee who knew the HMO's executive intervened and got the HMO to reconsider its exclusion.

More often, the effective board discusses how well programs and priorities reflect the needs of key constituents through its work, from approving the strategic plan to monitoring program performance. For example, some boards explicitly discuss how well the organization is meeting the needs of the elderly, the terminally ill, or new ethnic groups that have moved into the community. Other boards examine the relationship between the hospital and its physicians or the hospital and the business community.

Mission and Values Consciousness. Finally, the effective board of a Catholic health care facility ensures that the mission and values are expressed and advanced in all the organization's work. Some boards have a meeting evaluation form for trustees to rate how well the meeting incorporated discussion of the mission and values. Others engage in a discernment process when considering a major transaction or new program.

Still others have developed performance indicators for mission effectiveness, much like the financial and quality indicators used to measure those aspects. Catholic Health Initiatives is implementing a comprehensive mission effectiveness assessment built around 78 indicators in 10 categories, including core values integration, ethics, diversity, health communities, and advocacy. Boards of CHI's individual facilities review the assessment and incorporate the findings into their work and the goals they set for their organization.

Eight Principles for Building an Effective Board

Why are some boards very effective, adding value through their work, whereas other boards are passive at best and meddlesome at worst?

Virtually all trustees of Catholic health care organizations are committed to the mission and want to contribute constructively, but they often have varying expectations of their roles and that of the board itself. Some have served on boards of small organizations that needed hands-on trustee involvement to survive, whereas others are directors of corporations whose boards work at a high level on strategic and policy issues. Some trustees fully recognize their accountability to the sponsors and the community as a whole, but others mistakenly believe their job is to represent the interests of a single constituency such as the medical staff, the business community, or a single geographic area.

Trustees are not the only ones who have differing views of how the board ought to add value. Some CEOs want the board to be a fully informed partner in making key decisions, but other executives see a more limited role, such as providing advice and supporting the organization with key constituencies. No team can operate at optimal effectiveness unless each member knows his or her job and all members share common expectations of how they should work together. To build shared expectations, boards can discuss and adopt a written set of governance principles that define the roles, structures, composition, and processes that will allow the board to add value through its work.

Last summer, James Small wrote in this journal about common shortcomings of boards and introduced the concept of governance principles ("Making Boards More Effective," *Health Progress*, May-June 2000, pp. 28-32). Governance principles aren't "one size fits all." Individual boards will benefit most from developing a custom set of principles through an enlightening and unifying participative process. As a starting point for discussion, following are eight governance principles that are associated with effective board performance.

Accountability The board understands that its duty is to see that the organization acts in the best interests of the sponsors and the stakeholders whom it serves, including patients and the community. Board members bring perspectives and knowledge from outside endeavors, but they don't represent single constituencies. The board acts with diligence and objectivity on behalf of the stakeholders as a whole.

Responsibility To govern (and not manage, which is the CEO's job), the board focuses its work on six major responsibilities:

- Define the ends, policies, and goals of the organizations, beginning with the mission, vision, and strategic plan
- Make and support decisions that advance the ends
- Select the CEO, establish goals and expectations for the CEO and organization, evaluate his or her performance, and establish appropriate compensation
- Monitor organizational performance and exercise accountability for results, especially in the areas of mission effectiveness, financial stewardship, strategic direction, quality of care, and customer service
- Use influence with key internal and external

constituencies to advance the mission and vision

- Take responsibility for the board's own effectiveness

Exemplary Conduct Trustees exhibit trust and respect toward colleagues and management, honor the confidentiality of sensitive information, and scrupulously observe the conflict of interest policy.

Mission-Driven Board composition, structure, and work are designed to enhance the mission, vision, values, and strategic direction of the organization.

Streamlined The board's size and committee structure are as lean as possible to facilitate communication, participative discussion, and efficient decision-making.

Competency Board members are chosen to bring specific competencies and personal characteristics that will enhance the mission, vision, and work of the board. Competencies are developed further through orientation and ongoing education.

Value-Added Work The board focuses its meetings and other work on activities that add value for the organization, with an emphasis on high-level, strategic matters and critical issues affecting the future of the ministry.

Continuous Self-Renewal The board regularly evaluates its performance and uses the results to improve. The board also evaluates its performance as a whole as well as the performance of the chairperson and individual trustees.

Are principles such as these really valuable or just high-minded concepts? That depends on whether a board just adopts the draft principles with little change or uses the principles as a basis to engage in a soul-searching discussion about what effective governance really is. In such a discussion, a board might explore:

- "What does accountability really mean? Who are the stakeholders? Are we accountable to them, the sponsors, or both?"
- "Should governance principles make reference to required board oversight functions such as approving major financial transactions and monitoring financial performance?"
- "Does competency-based composition provide for inclusion of key constituencies?"
- "What sort of board and committee work enhances the strategic direction?"

There are no right and wrong answers to such questions, but through discussion a board can decide on principles appropriate to its mission and vision, organization, board culture, and the authority conferred by the sponsors.

Moreover, the governance principles allow a board to adopt specific best practices designed to enable it to add value. For example, the principle of competency suggests the need to develop written competencies, institute succession planning for board leaders, and develop orientation and education programs to enhance competencies.

Improving Performance

Do governance principles and best practices really affect board performance, or is their development just an academic exercise, the fruits of which are quickly forgotten? The answer depends on what happens after a board develops its principles.

The first step is to identify specific policies and structures and present practices that need to be changed to meet the standards set by the principles. Develop an implementation plan and charge a committee or task force with responsibility to oversee it. Perhaps most important, regularly evaluate the board's performance against the governance principles and develop strategies for continuous improvement.

Effective board performance is a goal, not a destination. It requires regular attention and fine-tuning, which should be the work of a standing governance committee, sometimes called the committee on trustees. It is responsible for board orientation, education, nominations, assessment, bylaws review, and other governance-related work.

The issues facing health care organizations in the decade ahead, captured well by Tim Porter-O'Grady last year in this journal ("Governance at the Crossroads," *Health Progress*, November-December 2000, pp. 38-41) make effective governance a matter of the highest priority. The time to ensure that governance is prepared to add value is not when a critical decision looms, but long before, when there is time to recruit, structure, and educate a talented and committed team of directors. □

NOTES

1. Ram Charan, "Boards At Work," Jossey-Bass, San Francisco, 1998, p. 28.
2. Charan, p. 11.
3. Betsy McKay, Nikhil Deogun, Devon Spurgeon, and Jonathan Eig, "Behind the Coke Board's Refusal to Let CEO Buy Quaker Oats," *The Wall Street Journal* (online), accessed November 30, 2000.
4. Greg Burns, "Crunch Time At Quaker Oats," *Business Week* (online), accessed September 23, 1996.
5. Lawton R. Burns, John Cacciamani, James Clement, and Welman Aquino, "The Fall of the House of AHERF: The Allegheny Bankruptcy," *Health Affairs*, January/February 2000, vol. 19, no. 1, pp. 7-41.
6. "Eckerd College Board Members Rush to Restore School's Endowment," *Board Member*, November/December 2000, vol. 9, no. 10, p. 2.

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