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Overcoming Warren Buffett's "Boardroom Atmosphere"

By Paul Pryzant and Vince Caracio

Warren Buffett wrote in his most recent annual shareholder letter that the problem with corporate boards is the "boardroom atmosphere," the desire of most people in a group to get along with one another. As a result, these titans of industry, aggressive and tenacious in their normal jobs, may become more passive when thrown together with their peers on a board of directors. Directors can have difficulty asking the tough questions at board meetings on issues such as CEO compensation, risk oversight, governance strategy, and board/CEO performance. As Warren Buffett so eloquently writes in his shareholder letter, to question a CEO mega-grant of options would be "like belching at the dinner table."

It is hard to argue with Warren Buffett. His investment track record over the past 40 years has earned him the title of "the greatest investor of all time." In addition, he has substantial experience serving on boards, with service on 19 public boards and interaction with approximately 250 directors. So when Warren Buffett identifies the key problem with corporate governance, people should take notice. Our goal with this article is to provide probing thoughts and questions to help directors avoid succumbing to the "boardroom atmosphere."

Until recently, corporate governance has not been viewed by many as being overly important. But a tidal wave of new laws and regulations has refocused our attention on the importance of corporate governance. These new laws provide an impetus for directors to improve board performance in order to mitigate the increased personal risks from serving on boards.

How do you overcome the "boardroom atmosphere" so that board members will exercise the independent, skeptical, and tough judgment that boards need? The following are some very workable best practices.

Director Summary: Heeding the advice of famous investor Warren Buffett, the authors help boards avoid a pervasive atmosphere of passivity by overcoming intellectual intimidation, asking pertinent questions about revenue and risk, and being courageous both individually and as a group.

The Courage to Overcome Intellectual Intimidation

Directors need to recognize when others are using intellectual intimidation as a means to stifle questions. In Houston, it was well known that Enron hired only the best and the brightest. With all of those high-powered brains, the concept of "getting it" became all important in the Enron culture. The CEO, Jeff Skilling, was quoted frequently in news articles, and was quick to refer in his speeches about times when he "got it." Those who "got it" quickly were praised for their brilliance, so people were quick to say they "got it" whether they did or not. To do otherwise would be an admission that perhaps they were not quite as brilliant as the others. At Enron, this game of intellectual intimidation stifled questions from being raised until it was too late.

This intellectual intimidation can and does occur regularly in boardrooms. Directors who fail to ask tough and constructive questions when they don't understand an issue are doing a disservice to the entire board and the company. To some people, to ask a question can be a very public admission that they either lack knowledge or understanding. But a director has to have the courage to make those admissions and to ask the questions that need to be asked. One director likes to ask questions by poking fun at his background: "Well, I grew up in Shreveport, Louisiana, and never made it to Harvard Business School, so could you please help me understand..." The other directors always laugh at his delivery, but never at his questions which are always incisive and drill down to the heart of the matter.

The Right Questions to Ask

How do you know the right questions to ask? At a recent securities law conference, a senior partner at a prominent law firm asked his fellow panel members to what extent a board member can rely on the advice of the company's accountants and attorneys. After all, he questioned, Enron was a very complex company and had numerous in-house and outside attorneys and accountants. Couldn't the directors rely on the advice of these attorneys and accountants? A fellow panelist, Judge Leo Strine, Jr., a Vice Chancellor on the Delaware Court of Chancery, responded that the first question that a board member should ask is: "How does this company make money?" If a board member does not know the answer to this fundamental question, then he or she should not be on the board.

Questions About the "Real" Risks to Your Company

Frequently, new and experienced directors ask the same old questions and focus on "rear view mirror" issues rather than the future direction of the company. In particular, many directors think of "risk" as those events that are covered by insurance. For most companies, however, the biggest risk is that the company's business plan will fail. Here are four tough questions that every director needs to ask:

1. How does the company identify and prioritize the primary risks to its business plan, and who monitors them on a real-time basis?
2. What are the company's most pressing strategic business risks and how do they compare to those of the company's major competitors?
3. What customer-related business risks are most significant to the company's future, and how does the company identify and measure those risks?
4. How does the company identify and reprioritize its business risks in light of rapidly changing economic and competitive pressures?

The Power of One Director

No matter how big the board is, one director can exert a strong influence on a board. As boards are starting to shrink, this power of each director will grow even larger. William George, the former CEO of Medtronic, a medical device maker, tells a powerful example about the influence that even a lone dissenter can have. As he told a *Wall Street Journal* columnist, 11 of his 12 directors had approved a $2.5 billion acquisition. The lone dissenter called Mr. George after the meeting to argue that the acquisition was ill-advised because it would divert Medtronic's attention from its core business. His arguments were so convincing that Mr. George convened a conference call of the board to discuss the dissenters' views, and the board ultimately voted against doing the acquisition. Mr. George later told the dissenting director how much he admired his courage and willingness to stand against the board.

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Other Ideas to Overcome the "Boardroom Atmosphere"

Meet regularly without the CEO. It has become standard policy to recommend that the board meet regularly without the CEO or other members of management. To make these meetings effective, time needs to be set aside at each board meeting for executive sessions without management. When these sessions become a regular part of each board meeting, they will raise fewer concerns with the CEO when they occur. Further, the need for secrecy during these executive sessions is critical, so that directors can discuss any issues openly. The chairman or lead director has the responsibility to set the tone and facilitate the executive session, solicit the views of the other directors, and summarize the discussion for the CEO, including any recommendations for action.

The role of the lead director. Another best practice that is gaining credence among those boards that have not separated the roles of chairman and CEO is to appoint a lead director. The lead director has three very important duties. First, the lead director needs to be fully involved in setting the agenda for board meetings. This ensures that all relevant issues are discussed. Second, the lead director must make sure that the flow of information to the board is relevant and in a format helpful for the directors to review prior to the meetings. Finally, in the meetings and executive sessions, the lead director needs to make sure that discussions of important issues lead to solutions and actions by the board.

Assigned roles for each member. Boards may want to assign certain tasks among the directors to keep them fully engaged in their oversight duties between board meetings. This is also a way for the directors to gather information from outside the board meetings and free from management's influence. For example, some of those assignments might be:

- To monitor news and Securities and Exchange Commission filings of competitor companies.
- To monitor best practices of other boards and compensation trends at similarly sized companies.
- To contact senior managers to learn more about their business units, and to visit branch offices or plants, in both cases without senior management present.
- To keep current on the changing role of corporate governance in public companies and study the best practices of companies where "good governance" is a cornerstone.

At each board meeting, time should be set aside for those directors with outside assignments to share their knowledge and insights with the other directors.

Board evaluations. The board and each committee should have an annual self-evaluation of director performance. People behave differently when they know in advance their performance will be evaluated and the criteria measured. On an individual level, each director should be evaluated on whether they ask the right probing questions and promote healthy discussion about issues faced by the company. This annual self-evaluation provides each director with an opportunity to think about their role on the board and how they can improve both individual performance and overall group performance. If taken seriously by the board, self-evaluations can be another means to improve overall board effectiveness.

Continuing education. The members of the board should regularly attend training sessions such as those put on by the NACD and other outside organizations. This serves two purposes. First, to learn about the role of being a director and about the norms and best practices of other boards. While the formal part of the presentations can be very informative, the questions and answers can be even better. At a recent NACD meeting in Houston discussing the role of audit committees, it was refreshing to hear the audience provide their own experiences to help answer questions. The second purpose is to provide an opportunity to network with directors from other companies. No board can have all the right answers and best practices. This networking provides a more informal means to learn how specific practices are really working in other boardrooms.

Independent advisors. Boards need their own independent trusted advisors from time to time, whether an independent attorney or someone else. For some decisions, the board may want someone who can provide the perspective of "How will it play in Peoria?" or for that matter, on Capitol Hill. The Enron board members who waived the company's code of ethics on two occasions probably had no warning on the importance of those two decisions. At the time, the Enron directors were presented with a request from management who they had learned to trust and who they believed (as did many others at the time) had performed in exemplary fashion. Unfortunately for those directors and for Enron, they probably had no independent source of advice who could provide the needed warnings. This was a classic example of the "boardroom atmosphere" in action.

Each individual director can have a powerful impact on their boards if they have the courage to act when needed.

Boards cannot wait for a crisis to hire their trusted advisor; instead the advisor needs to be hired long before the advice is needed. If a board waits until the last minute, the crisis atmosphere does not provide the advisor with the needed context and perspective for effective advice. The result is then either delay or ill-informed advice, neither of which is acceptable. Further, an advisor has to build that trust with the members of the board over time.

Overcoming the Boardroom Atmosphere on Your Board

Recognizing and responding to intellectual intimidation, asking the right questions, and being an educated director are actions for each individual director. Other actions, such as having regular executive sessions, appointing a lead director, conducting regular evaluations of board performance, and engaging outside advisors, require group action by the board. But as the example above from Medtronic illustrates, each individual director can have a powerful impact on their boards if they have the courage to act when needed.

Warren Buffett has sounded a warning to all board members that they cannot afford to ignore in the current environment. The "boardroom atmosphere" exists in all boards to some degree, and it takes concerted effort to overcome its influence. Directors need to recognize the effects of the boardroom atmosphere and take active steps to surmount it. If they do, boards can be more effective and will fulfill the oversight role expected of them by both the company's shareholders and the investing public. ■

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