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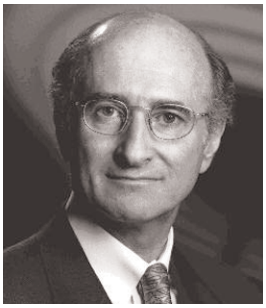

Leading the Board through Critical Events and Crises

By Allen Karp

Further advice from the NACD Blue Ribbon Commission on Board Leadership.

Boards need independent leadership during various times in their life cycle—including initial public offerings, the acquisition of other companies, or restructuring. At no time, however, is a board under more pressure than when confronted with a crisis or a critical event such as possible insolvency, change of control, or a financial scandal. Depending on the nature of the event—and particularly if the crisis impairs management's ability to lead the company—it may demand action and significant amounts of time on the part of the board. Regardless of the nature of the crisis, its handling can have significant implications for the company and its shareholders.

Board Leadership When a Corporate Crisis Erupts

The first decision a board must make when crisis occurs is whether it is appropriate for the CEO to lead the company through the crisis. If he or she is part of the problem or is otherwise compromised or conflicted, someone else—often one of the other directors—should take a leadership role.

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When an apparent crisis begins, the CEO and the board first need to get a measure of the magnitude and severity of the situation. To do that, the CEO and the leader of the independent directors should communicate right away. In some cases, an emergency meeting of the full board will be necessary. Once briefed on the situation, the board should meet in executive session and decide if the company is indeed facing a crisis, and if so, whether management can properly handle the situation or if there is a potential conflict. The leader of the independent directors plays an important role in mobilizing the board to make these determinations.

In deciding who should lead the company through the crisis, the board (or the independent directors meeting in executive session) must immediately determine which of two broad categories of crisis the company is facing:

- Is it a crisis facing the organization where company leadership (the CEO and the executive team) are in the best position to manage the situation, drawing on the board's experience, as appropriate? (Examples of this type of situation would be a product liability issue or an environmental problem.)
- Is it a crisis where the CEO is either the root of the problem or is somehow compromised in leading the company, requiring the board to assume a leadership role? (Examples of this type of situation would include the death or illness of the CEO, allegations of corporate fraud or other illegal activity, or the inherent conflict for a CEO presented by a buyout.)

If the CEO will be taking the leadership role in handling the situation, the board does not abdicate its responsibility. While the CEO provides leadership, the board still must be kept informed and exercise its oversight duties. When a company's reputation and financial future ride on how a crisis is dealt with, there is no time or room for missteps. It is the job of the leader of the independent directors to make sure that the board is partnering effectively with the CEO at this critical time, serving as a sounding board, leveraging any relevant experience with similar crisis scenarios to help the CEO, and approving all key decisions.

If the crisis involves the CEO or it is otherwise inappropriate for him or her to lead the company, there is a need for an independent director to provide leadership. In some cases, the lead director may be the appropriate choice. However, leadership during a crisis calls upon a different set of skills than those required in ordinary times, specifically someone who is decisive and focused as opposed to a facilitator and consensus-builder. As such, a different independent director may be a better choice to provide crisis leadership.

Depending on the nature of the problem, it may be appropriate to assign leadership to a director who is an expert in a particular, relevant area. In an accounting crisis, for example, the most appropriate leader may be the chair of the audit committee. Alternatively, and depending on the nature of the crisis, the board may need to form an ad hoc board committee comprising directors who can devote significant time and energy to the situation. Particularly in a scenario where the CEO or senior management is linked to the problem, the leader of the independent directors has to make certain that the board has access to independent judgment, assessments, and advice on anything that may have contributed to the crisis. If there is a legal or accounting issue, the board or the appropriate committee chair should secure independent advice. In doing so, they should reach beyond their current advisors, since those advisors may also be compromised. In such situations, board members who are providing leadership must quickly step in, harness the skills and time of other directors, determine which outside advisors will be required to provide assistance, and play the public role required to quell any fears—among employees as well as investors—that may allow the crisis to deepen.

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Board Leadership During a Crisis

Whether or not the CEO is leading the company during the crisis, it is the board's responsibility to maintain effective oversight of how the crisis is being handled, and to either make critical decisions or ensure that they are being made. Boards should consider using a special committee of independent directors for this purpose. When the situation is most critical, the CEO and the board should be in frequent contact.

Communication between the CEO and the leader of the independent directors—and among all directors—should greatly intensify in frequency and detail during a

Director Summary: In times of crisis, first decide who should lead the company through the crisis. Develop a thorough risk management plan, including an emergency CEO succession plan. Ensure there is at least one director who could step in immediately to lead crisis management.

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crisis. If the CEO remains the leader of the company, the leader of the independent directors must insist that he or she is continually kept in the loop, and that all of the other directors are also updated regularly.

To help guard against any errors in judgment that might worsen the crisis, the board must provide effective oversight of management dealing with the crisis. This requires a balance of ensuring that management is dealing effectively with the problem while not consuming an inappropriate amount of management's time at this critical juncture. And as management lays out and executes a plan to deal with the crisis, board members should receive regular updates on alternatives, implications, and results. At the most critical stage, the CEO and other leaders in corporate management dealing with the crisis should be in frequent contact with the board, recognizing its crucial role in overseeing management and protecting the company and its owners.

At a time when both employees and outsiders look to the board for assurance, board leaders should discourage the resignation of any directors, except under the three circumstances noted below.

During a crisis, the board needs to be viewed as a unified team pulling together, and also needs to function this way. Those outside the boardroom may view resignations as a sign of a fractured board at precisely the time when directors want to present a united front.

Resignation may be appropriate, however, or even necessary in a few instances:

- If a director notices the persistence of a problem such as unethical behavior previously reported to the board and management.
- If a director contributed to a crisis.
- If a director has insufficient time to deal with a crisis—although this circumstance should be avoided, if at all possible, by proper vetting in the director recruitment process.

To manage a crisis properly, the leader must also be available to advise the company's corporate communications director. It is important to determine up front who the spokesperson will be during the course of a crisis. The spokesperson—likely the CEO if he or she is the leader—will be the face of the crisis for internal and external audiences. In all communications, there should be a commitment to truthfulness and sharing of what is both possible and prudent at any given time.

Sometimes, the board itself may face a "crisis" of its own because of warring factions on the board, the sudden loss of a board leader, or other critical board events. Although crises at the board level are obviously much smaller in scope than crises engulfing entire companies, board leaders need to anticipate and manage them using the general principles advocated here.

Forearmed When Possible

Boards should require management to develop a thorough risk management plan—if one does not already exist—and ensure that it is kept up to date.

It is obviously impossible to predict the nature or timing of any particular crisis. However, some industries are more exposed than others to certain types of crises. For example, consumer products companies can prepare for malicious tampering, and energy companies can prepare for oil spills. And all companies can prepare for the sudden loss of a CEO, or for a hostile takeover (in the case of public companies). On an ongoing basis, effective oversight by the board is the best insurance that any crisis that can be prevented will be.

Directors must make it their business to thoroughly understand specific risks facing the organizations they serve as directors. Board leadership should make sure that management has created a well-thought-out risk identification and management plan and that it is regularly updated. Then they must ensure that there is a warning system in place to alert them to occurrence of risks in a variety of categories, including short term versus long term and intrinsic versus extrinsic.

Obviously, companies cannot predict and plan for all potential risks. It is important, however, to keep risk management on the board's radar. The board should ensure that the company is making an effort to identify all possible risks—and planning prevention and response for those risks that are most likely to develop into crises. Many companies maintain an up-to-date crisis management plan that includes the worst and most likely risks, as well as the contingency plans and resources that may be required to manage them.

Other companies demonstrate even more active involvement in forearming themselves for potential disaster, including running drills. Another approach is to invite a CEO or director of a company that has dealt with a crisis to share his or her experience with a board planning for a similar crisis. Since all of these crisis-planning activities take time away from the real business of the company, board leadership should work with management to carefully weigh the likelihood of any event against the inevitable distraction from carrying on with the day-to-day business. For more specific guidance on this topic, please refer to the *Report of the NACD Blue Ribbon Commission on Risk Oversight: Board Lessons for Turbulent Times.*

Emergency Succession Plan for the CEO

While many potential crises may be difficult to anticipate, one type of crisis that all boards need to consider is the sudden loss of their CEO, whether the cause is sudden death, illness, injury, resignation, or accusations of malfeasance. Developing an emergency CEO succession plan is a crucial board responsibility. Such planning should be conducted by the board or a board committee in conjunction with the CEO, reviewed with and approved by the full board, and updated at least annually.

If a capable and proven successor is ready to take the reins in the event of a sudden departure, boards engender confidence—within and outside the company—that things are well in hand, heading off potential damage and protecting the interests of shareholders. This type of planning for emergency CEO succession requires the board and the CEO to consider and reach some conclusions about:

- How would the members of the current executive team lead the company in the event of the sudden loss of the CEO? Is there an obvious choice to serve as interim CEO, for instance, and if so, do the current CEO and the board agree on who that is and why he or she is the best choice? Who would fill in for that executive in his or her current role?
- If, in the event of the sudden loss of the CEO, which board member should serve as interim chair?
- How might this emergency succession plan be broadened to apply in circumstances involving the loss of the top three officers (a situation often referred to as "the company plane crash scenario")? Also, what policies are in place with respect to top officers traveling together?
- Are there emergency succession plans in place for a range of top officers—the chief financial officer, chief operating officer, or others? If so, has the CEO reviewed these with the board? Has the board had an opportunity to meet the executives who would be stepping into these key roles in an emergency situation?

Once emergency succession plans for the CEO and other top officers have been developed and agreed upon by the board and the CEO, they should be reviewed and updated at least once a year, or at any other time when a change in top management would affect such plans.

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Implications for Board Composition

Recommendation: **The governance committee should anticipate board leadership needs during a crisis situation when designing board and committee composition—including ensuring that the board has one or more directors with crisis experience, crisis-specific leadership skills, and the ability to devote full time and attention to a crisis, should this be required.**

In addition to overseeing management with an eye toward crisis prevention and (worst case) response, it is also important that the board carefully and regularly assess its own resources to deal with a variety of contingencies. Boards should strive to recruit directors with both the skills and time to deal with a crisis, if and when it happens. Board leadership must ensure that the governance committee performs a periodic inventory of the skills and experience required on the board, including what will be required if the company were to face a crisis:

- To ensure director availability during a crisis, boards should have a policy limiting the number of other boards their members may serve on. In 1996, well before the advent of Sarbanes-Oxley and the stock exchange listing requirements, the NACD Blue Ribbon Commission on Director Professionalism recommended that CEOs limit their service to no more than two public company boards, and that other individuals with full-time employment limit their service to four such boards, and for retired individuals, the suggested limit was six. Board service in the private and nonprofit sector may be equally demanding, and policies should take this into account.
- In addition to having a board made up entirely of directors who have the time to serve effectively, every board should identify directors who could literally drop everything were a crisis to hit. Since directors often have a primary responsibility at another company as a CEO or another senior manager, scheduling may prove difficult when a board is in the midst of a crisis. Board leaders, in particular, need to be able to commit the time required—on short notice and for extended periods. Considering these demands, boards may wish to think about recruiting directors from the ranks of recently retired

Work with management to carefully weigh the likelihood of any event against the inevitable distraction from carrying on with the day-to-day business.

senior executives (CEOs, chief operating officers, and chief financial officers) who have both the practical operating experience and the time to commit in a crisis situation. NACD governance surveys consistently show that some directors (nearly one-third in 2003) actually prefer retired CEOs to active CEOs when recruiting directors. (*NACD Public Company Governance Survey 2003-2004*, Washington, D.C., NACD, 2003.)

- Nothing takes the place of experience when dealing with challenging, high-risk situations. When adding new directors, board leadership should consider appointing someone who has been on a board that has effectively dealt with a crisis, particularly in an area that has been identified as high-risk for a particular company. For example, if a hostile takeover is a possible risk for the company, the governance committee would be wise to consider someone who has experience in such scenarios when they conduct director recruitment.
- Leadership should determine whether the board has or needs someone with the proven leadership skills to effectively deal with a crisis. As already noted, crisis leadership calls upon a different set of skills than those required in ordinary times, specifically someone who is decisive and focused as opposed to a facilitator and consensus-builder.

Perhaps most importantly, the CEO and the board as a whole should review plans for various types of crisis situations—including who would play what role in different scenarios—so that in the midst of a crisis, critical time is not lost deciding who will take charge of various responsibilities and how they will deal with them.

After the Storm: Learning from Experience

Recommendation: **After the crisis has passed, the board should do a careful analysis of the crisis—what caused it, how it was handled, what could have been managed better. If appropriate, an independent, third-party investigation may be considered to ensure objectivity.**

A board that has helped a company weather a crisis can learn from the experience—there are valuable lessons here that can make for a stronger company. Soon after the crisis has passed, the board should see to it that there is a record of what occurred, how it was resolved, and, most important, any safeguards being implemented to prevent recurrence. The board should work with the designated spokesperson and with legal counsel to make appropriate statements to the public in this regard.

Then the board's work should turn inward. The leader of the independent directors, together with the CEO and the board—in executive and full board sessions—should perform a complete analysis to examine both the causes of the crisis and how it was handled, with an eye toward using the experience to establish best practices and to avoid and/or manage any future crises even more effectively.

Because a crisis is such an important learning event, it is important to conduct an objective analysis. The independent board leader may wish to consider engaging an independent third party to conduct an investigation of precipitating events of the crisis and response by management and the board so that lessons can be applied in the future.

Conclusion

Effective risk oversight, like effective board leadership itself, can engage board members on the most significant issues that affect the health of the enterprise. Put to the test by crisis, the effective board will do its work as a group, make good decisions, and provide good guidance in a time of need. ■

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