Magazine Article / Corporate Governance

How the Best Boards Engage with Management

In every case, consider the context before you act. *by Timothy J. Rowley and Laurence Capron*

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The recent tumultuous episode at OpenAI, whose CEO, Sam Altman, was fired and then reinstated in a matter of days, highlights a fundamental board challenge: how to provide proper oversight of management while allowing it the autonomy it needs to be effective.

Our research on governance practices reveals that most boards maintain a single mode of engagement at all times, regardless of the type of decision to be made or its importance. This lack of flexibility can significantly undermine board effectiveness, especially in complex and rapidly changing situations. A board that defers to management during a major strategic acquisition, for example, leaves executives unsupported and may expose itself to legal liability.

In this article, we present a step-by-step governance approach to help boards foster a more contextually relevant—or, as we term it, agile—relationship with management that allows them to better perform their fiduciary duties and improves organizational outcomes. It is based on our analysis of 400 reports written by directors who have attended our governance education programs over the past decade. In the reports, directors assessed their board's practices and overall effectiveness. We also interviewed and surveyed many other board members about their practices. Drawing on our research, we identified four modes of engagement—passive, mentor, partner, and control—along with the unique characteristics of each type and the combinations of engagement modes most likely to enhance board effectiveness. While boards differ in their practices to some extent, largely owing to variations in ownership structures, consistent patterns emerged across industries and geographies.

We'll begin by looking at the different modes of engagement between board and management.

The Modes of Engagement

Boards engage with management using a variety of approaches along a spectrum, ranging from entirely hands-off to strong control. A key success factor for each of the modes is who holds the information central to a negotiation, strategy decision, or other interaction: management or the board.

Passive mode. This mode allows management near-total discretion in decision-making. Board meetings are dominated by executive presentations aimed at “selling” the board on decisions that have already been made. Management rarely presents alternatives to the proposal under consideration. Passive boards typically suffer from a large information disadvantage, lacking access to crucial company data necessary to make informed decisions. As a result, they often stick to matters of regulatory compliance, allowing management to set goals, make strategic decisions, and allocate capital freely. Passive boards typically refrain from challenging management’s strategic recommendations, even on significant matters such as shareholder relations and CEO succession.

Mentor mode. Boards using this mode allow management substantial authority on decisions, but they participate in the discussion of various options early on. Management comes to the table looking for advice and relies on the board to provide constructive feedback, question recommendations, and even propose new options. Directors on mentor boards are often knowledgeable about the business and its industry or have experience in similar industrial or organizational contexts, though they rely on management for detailed company information and initial ideas. Compared with boards operating in the passive mode, mentor boards dedicate less time in meetings to management presentations and more to the discussions that follow.

Partner mode. Partner boards also allocate more time in meetings to discussion than to management presentations. Board members usually have their own expertise and will often gather relevant information beforehand, enabling active participation in discussions. Unlike mentor boards, however, partner boards do more than offer advice; they must formally approve management recommendations. Many members of partner boards described decision-making as a negotiation between the board and management, with the board closely overseeing implementation. Neither side has a significant information advantage over the other. One interviewee whose firm was in the midst of an acquisition told us: "The board's role is to provide the strategic direction, ensure solid due diligence, mitigate risks, make informed decisions, and oversee the transaction."

Control mode. At the end of the spectrum is the control mode, in which boards retain almost total decision-making authority. Management participates in the process, but the board makes the final calls. Board members working in this mode are deeply invested in the company and allot a significant amount of time to their duties. The mode is appropriate for some decisions, including CEO compensation and succession, setting mission and goals, and selecting new board members. But some boards overuse the mode and spend valuable meeting time on nonstrategic issues as a result. One director we spoke with, for instance, recalled a meeting in which the board spent an hour discussing which car models should be available in the employee auto-leasing program. Meeting time is often dominated by detailed critiques of management presentations. Executive teams, lacking decision authority, use what little information advantage they have to nudge the board toward their preferred proposals.

Trapped in a Single Mode

Although some boards operate in multiple modes, our research reveals that most stay in a single mode regardless of the decision at hand or the circumstances surrounding it. Only 9% of boards in our study engaged with management using more than one mode. And unfortunately, the passive mode is the most common. Almost half the boards in the study operated as little more than a rubber stamp, deferring to management on crucial matters such as M&A transactions, board agendas, and even board appointments. In fact, the passive mode of engagement is more prevalent (at 46%) than the mentor (14%), partner (12%), and control (19%) modes combined.

Of course, it is to be expected that boards take a passive role in many decisions, since management is usually best positioned to execute company strategy. Nonetheless, we find that mentor and partner modes are underutilized across various settings, especially when management can benefit from directors' practical advice and when a key decision —such as a strategic change or a potential acquisition—could have a significant impact on shareholder value. Mentor and partner modes also foster an environment in which CEOs feel comfortable sharing concerns —unlike passive and control modes, both of which discourage CEOs from revealing vulnerabilities.

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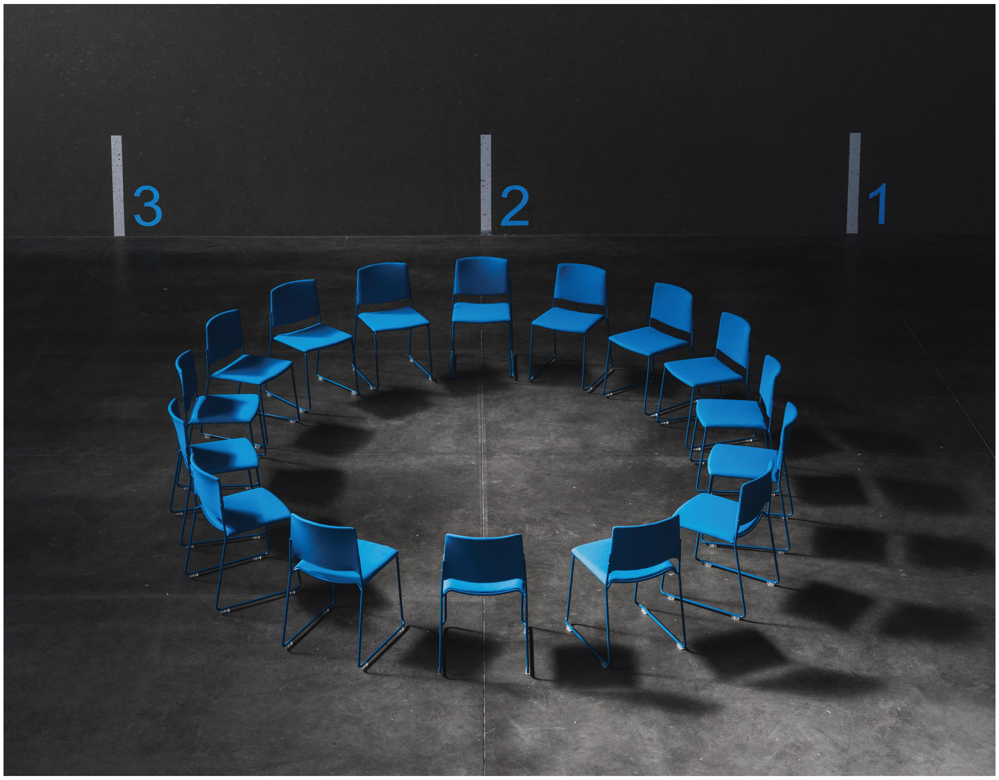
For firms under competent management, the risks of the passive mode are low. But if something does go wrong, boards often overreact and switch suddenly to the control mode, inserting themselves into a wide range of decisions. Not only can such an abrupt transition be disruptive, but having a history of passive engagement, these boards usually lack sufficient information or context to play the mentor or partner roles. In such situations, directors tend to overemphasize negative information and have a bias for quick solutions. Very often, the solutions they come up with involve replacing key executives. As one board member told us, "We quickly go from thinking the CEO is brilliant to talking about their shortcomings."

The board of a U.S.-based, publicly traded healthcare organization followed this engagement pattern. The corporation was composed of more than 12 business units, many of which involved complex medical technologies and served multiple differentiated markets. Understanding the business from a board seat required substantial effort, which few of the members had invested the time in. In addition, six of the 12 members had been appointed in the past 18 months. Consequently, the board suffered from a low level of business knowledge, and board meetings were dominated by long management presentations. When the organization suffered a substantial financial downturn, the board reacted to investor pressure by swinging to the other end of the spectrum. Rather than moving to a mentor or partner mode, and despite the fact that it still lacked sufficient knowledge to make sound decisions, the board took full control. In this case, as in many like it, the CEO was replaced, and the organization's market capitalization fell.



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Even when boards do adopt more than one engagement mode, they typically switch between passive and control modes. Mentor and partner modes are rarely considered. This may be because many board members define their job as policing management, and as a result, they limit their attention to monitoring financial performance (Is the team doing what it's supposed to?) and the team's composition (Do we have the right people in place?).

That interpretation of a board's role is too narrow. While financial performance and the composition of the top team are certainly key parts of the job, they are not a complete description. Properly deployed, a mentor or partner board can be a source of great value to a company and its shareholders: It acts as a sounding board for new ideas and helps stress-test plans for any major strategic decision, and in doing so, it more completely fulfills its fiduciary duty.

One particularly agile board we studied exhibited all four levels of engagement, playing mentor and partner roles extensively. This board oversees a medium-size Europe-based tech organization that services clients globally. The ownership structure is a joint venture among multiple organizations that are not only shareholders but also clients. In addition, the shareholder organizations are competitors. Each shareholder organization has the right to appoint a board member; however, the chair is independent of the shareholder organizations.

Agile boards calibrate their engagement level to reflect the degree of risk associated with each decision.

Experts might predict that such a complex governance structure would lead to an ineffective board, owing to inherent conflicts of interest, and that board members would mistrust one another and worry that the others might overstep their roles. However, the organization has performed above its targets, and the management and board relationship is functioning well. The CEO is comfortable with the way the board offers support and asks questions, stating, “My board provides clarity about what it wants from me.”

This success can be attributed, at least in part, to the board’s explicit goal to be agile. The board ceded many decisions to management, including the R&D road map, talent review, and cybersecurity. It took control of decisions directly involving shareholder and stakeholder issues, such as capital structure, CEO succession, and shareholder communication. Because the CEO was relatively new to the role and a first-time chief executive, the board played a mentoring and partner role for decisions that, in other settings, might have been placed in the passive category. For example, when the CEO wanted to change the organizational structure, the board took on a partner role because many of its members had more relevant experience than the management team did. The board gave management discretion to run the daily operations but got more involved on certain issues as it deemed appropriate.

Becoming an Agile Board

The key to becoming an agile board is to understand that the appropriate mode of engagement depends on the decision to be made. Boards should define themselves not by a single relationship with management but by the array of relationship modes they need to engage in to optimize decision-making. They must determine in advance whether a given item on their agenda requires them to be passive, to act as a mentor or partner to the executive team, or to take control.

Many factors can affect which board engagement mode is right for a given decision. However, our interviews revealed that four are critical:

Impact on value. Boards are ultimately responsible for long-term value. Agile boards calibrate their engagement level to reflect the degree of risk associated with each decision. If the matter at hand has very little impact on value, the board can safely assume a passive role. Recall the example about the various car models to be offered in a company car-leasing program: That was a waste of the board's time. Such low-stakes decisions should never reach the board; if they do, the board should simply ratify them and move on. But if a company is contemplating a multibillion-dollar hostile acquisition of a major competitor, the board should almost certainly act as a partner in the decision.

Conflicts of interest. Boards must manage conflicts of interest involving management, board members, and owners. When management is facing decisions for which executives' interests are potentially misaligned with those of other stakeholders, boards must consider greater engagement. It is for this reason that choosing the next CEO is a task that only the board should control: Although the outgoing CEO and current management provide valuable input, they have a lot of skin in the game and may not be best suited to decide who should lead the company in the future.

Implications for mission. An organization's mission and goals are set with its owners and external stakeholders in mind. It is the board's fiduciary duty to make sure that management is making decisions consistent with that mission. If management is considering making moves that represent divergences from the stated mission or goals—for example, strategic choices such as entry into new markets or brand repositioning—the board must consider partnering in or taking control of decision-making.

Talent and capabilities. Our interviews with directors revealed that boards occasionally become more engaged when their members possess important skills or knowledge that management lacks. In such instances, the board might move from passive to mentor or partner mode. If a company is entering a joint venture in China, for example, a board whose members have experience doing business there should consider a mentor role. More generally, we see boards shifting engagement levels on the basis of their level of confidence that management can successfully implement a strategy and achieve performance targets.

Finding the Right Mode

Let's look at how your board can learn to make the right choices.

Step 1: Take stock. Your board and your management team should begin the journey by creating a decision inventory. Together, identify the main categories of decisions facing the organization and determine who should take the lead on each one. This process will drive home the need for multiple engagement modes depending on factors such as the risk associated with each decision, the overall business context, and so on. (See the exhibit "Setting Default Modes for Decision-Making.")

Setting Default Modes for Decision-Making

To be effective, a board must tailor its mode of engagement to the decision at hand. It should create an inventory of all the decision categories the company might face and define default modes for each one. The board should be prepared to shift modes in response to changing business conditions. This sample decision inventory shows typical default modes for decision categories commonly faced by boards.

Mode of board engagement

Decisions	PASSIVE	MENTOR	PARTNER	CONTROL
Mission and goals				●
Strategic direction		●		
Resource allocations		●		
Mergers and acquisitions		●		
Organizational structure change			●	
R&D road map and digital transformation	●			
Manufacturing and operations	●			
Marketing and sales plans	●			
C-suite leadership changes and incentive plans (non-CEO)		●		
Talent review and compensation	●			
Financial management (capital structure, liquidity, dividends)			●	
Audit			●	
Cybersecurity	●			
Shareholder relations				●
Stakeholder engagement, CSR, ESG			●	
Government regulations and compliance			●	
Risk management			●	
CEO compensation				●
CEO succession				●
Board member changes				●

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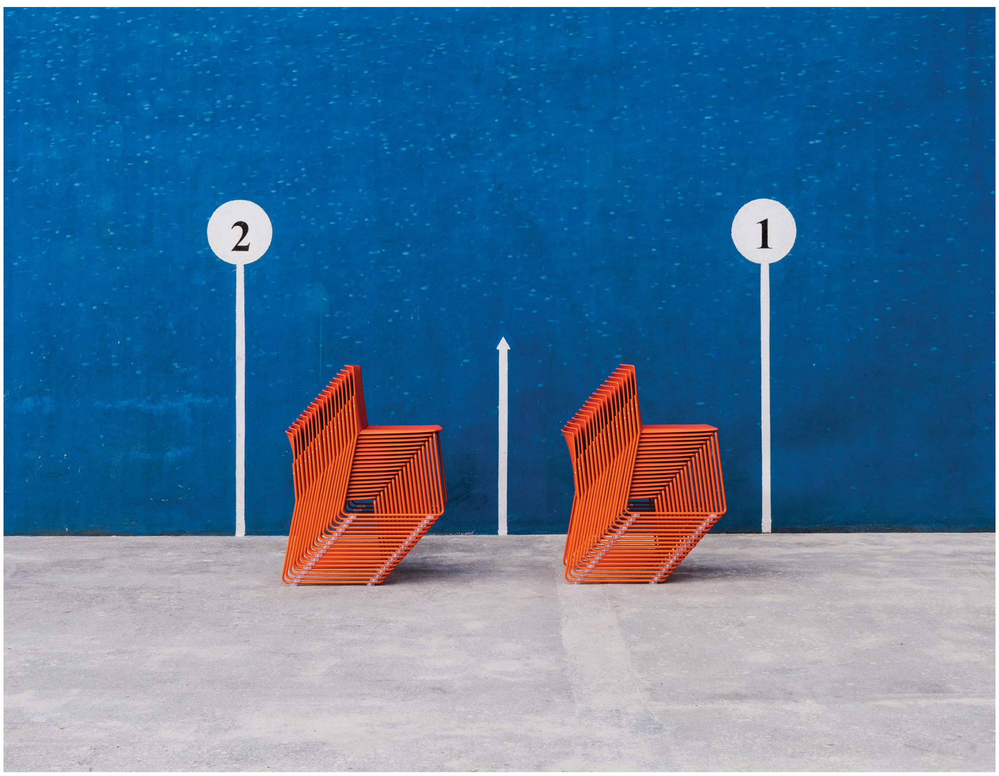
Board members and executives usually quickly agree on certain decisions. We find that decisions fitting into the passive and control modes are easiest. For example, the default position for employee decisions below the C-suite—such as talent review and development and bonus programs—often require only passive board involvement. In addition, most boards quickly agree that CEO succession and compensation should be in the control category. But boards differ on other decision types. For example, we have observed boards placing CFO hiring decisions in the mentor, partner, and control categories. Engagement modes must be tailored to the decision at hand, the composition and expertise of the board, and the organization.

Consider the different engagement strategies two boards used for making technology-road-map decisions. The first chose passive engagement. Its company was in a stable market, had a solid balance sheet, and technology represented less than 30% of the firm's annual capital allocation. The other board oversaw a firm that was competing in a new industry, had a weak balance sheet and constraining bank covenants, and allocated more than 80% of its annual capital allocation to technology—so it chose the partner mode. Similarly, when it comes to acquisition decisions, the level of engagement of the board increases with the strategic value and size of the deal, the financing needs, and the strength and maturity of the management team. As one director put it, "When the management team is at a lower level of maturity, the board should be more involved, perhaps through a committee, to augment management assessment capabilities and ensure that deal execution capacity is in place."

Step 2: Manage the engagement. The default positions for each decision are appropriate provided the underlying conditions do not change. However, once the context shifts, the board chair and the CEO must discuss whether the default engagement levels for each decision on a specific agenda are appropriate.

In most cases, the answer is yes. But when the engagement level needs to change, the chair must bring the discussion to the full board. The chair should inform board members when more preparation is required for a particular decision and should adjust the time allocated for management presentations or discussions to allow for the correct engagement level.



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Boards can use this kind of agenda-item review to consider short-term or specific decision conditions that require a new engagement mode. That doesn't mean that the default position on the decision category will change. For example, one company we observed was doing an M&A

transaction involving a target firm in which the CEO owned stock. Given the obvious conflict of interest, the board moved from a partner to a control engagement level. But that shift did not set a precedent for future transactions; the board would continue defaulting to partnership mode.

In addition to agenda-level reviews, boards should conduct annual engagement reviews to address systemic changes. At one company we observed, which was engaged in a growth strategy focusing on acquisitions, the board had initially adopted a partnership approach. But after two large transactions were completed, the remaining targets were deemed to be a roll-up exercise involving much smaller investments and risks. In addition, the board believed that the management team's process was effective, and it had an open and transparent relationship with the executives. Given those conditions, this agile board decided to move M&A transactions to a mentor engagement model.

After reviewing new circumstances that affect decision-making, the board should adjust its level of engagement accordingly. This adjustment tends to happen more readily during a crisis because of the heightened awareness of the need for change. For example, our research showed that at the onset of the Covid-19 pandemic, agile boards modified their engagement levels, becoming less passive and moving to mentor and partner modes. Notably, most board members and CEOs we interviewed expressed a preference for this pandemic-era engagement, which provided CEOs with more advice (mentor mode) and facilitated better board discussions (partner mode) on critical issues.

The pandemic represented an existential threat to businesses in important ways, and neither management nor boards had the experience or skill sets to fully take the lead on responding. More-collaborative engagement was clearly called for. Unfortunately, our research shows that board engagement is reverting to prepandemic patterns, underscoring the need to stay on top of this issue.

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To thrive in today's dynamic business environment, boards must shake off their static patterns of engagement with management and embrace a more dynamic approach. By tailoring their involvement to the nature and importance of each decision, boards can provide better oversight and support. Ultimately, agile boards not only enhance their own effectiveness but also foster a more collaborative and productive relationship with management, driving improved outcomes for organizations and their stakeholders. That is not just a nice-to-have—it's a necessity.

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