

WIB/AABD Annual Directors Conference

The Ten Essentials of Corporate Governance



Laurel Management Systems, Inc.

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Contact: oliver@globalbanktraining.com

The Ten Essentials of Corporate Governance

- Normally such lists focus on day-to-day minutiae, (structure, process driven)
- Governance is a high-level function:
 - Strategic
 - Big-Picture
 - Considers the future
- Look at the topic from a higher level strategic perspective

The Ten Essentials of Corporate Governance

- From the viewpoint of what each individual director should be willing to contribute
- Major Problem – the vast majority of community banks have never prepared job descriptions for directors
- Governance Committees should make it a priority to develop written, formalized job descriptions for their directors

1. Learn

- The changing nature of the industry demands that we all stay up to date.
- Best practice in corporate governance - Boards should implement a policy of ***Continuous Learning***:
 - Regular **Reading Circulation List**
 - Conferences / Seminars
 - Internal Resources

*There is nothing more frightful than ignorance in action.
(Goethe)*

2. Participate Actively and Intelligently

- “But I’m new on the board so I’m sitting back and watching”
- “But the others know much more about this subject than I do”
- “I rely on management to steer me right on most things”

The board is in place to act a system of checks and balances for management decisions and if you do not participate actively and intelligently you fall down on the most fundamental responsibility under common law

3. Question

- System of CHECKS AND BALANCES
- Common Law – DUTY OF CARE
- Be willing and prepared to question
- Be INDEPENDENT:
 - in thought and action
 - consider Sarbanes-Oxley
- Beware “GROUP THINK”

3. Question

Beware "Group Think"
Asch
Group Conformity Research



If everyone is thinking
alike, then somebody
isn't thinking.

(George Patton)



4. Think Strategically

Strategy without tactics is the slowest route to victory.
Tactics without strategy is the noise before defeat.
(Sun Tzu)

- See the big picture
- Consider the CUSTOMER in all strategic decisions
- Recognize the importance of CULTURE
 - Citibank
 - Umpqua
 - Gap
- Develop a Code of Ethics BUT written codes DO NOT drive ethics. Behaviors drive ethics.

4. Think Strategically

- Culture (Big-Picture)
- Understand organizational culture!
- What is organizational culture?
 - “How we do things around here”
 - Like DNA – how and why we do what we do
 - Vast range of assumptions and beliefs about the best way to achieve certain results, developed through experience
 - Management/employees of financial services industry have often had similar experiences and therefore share the same beliefs and values

4. Think Strategically

Be an individual - arrive at a common voice

COMMON SENSE

+

COMMON LAW

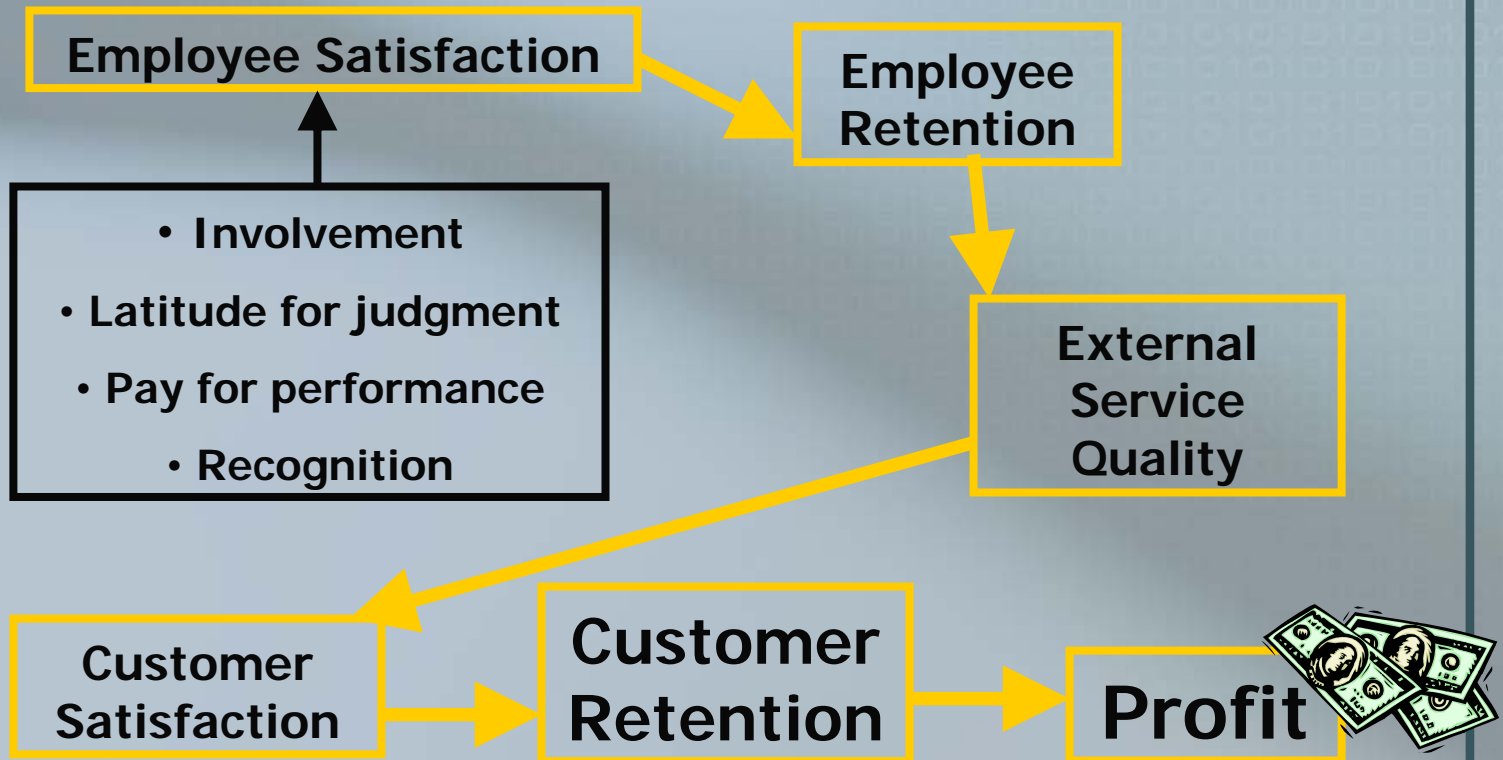
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COMMON VOICE

4. Think Strategically

- Culture (Big-Picture)

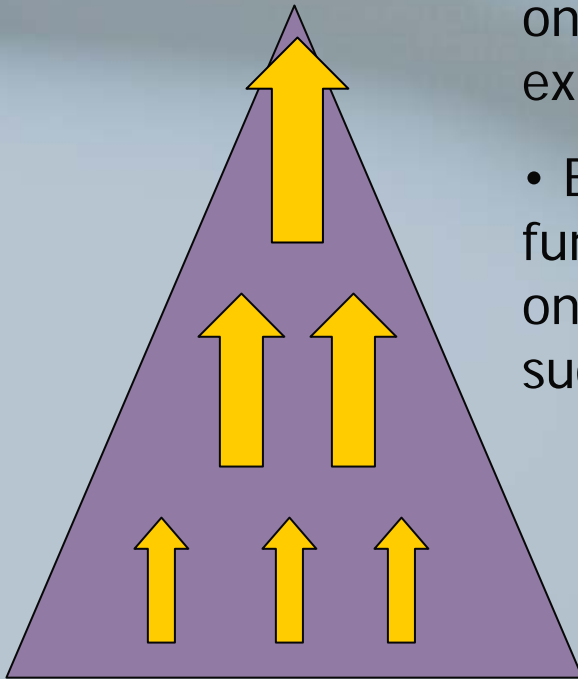
Heskett's Service-Profit Chain
(J.L. Heskett – Harvard Business School)



4. Think Strategically

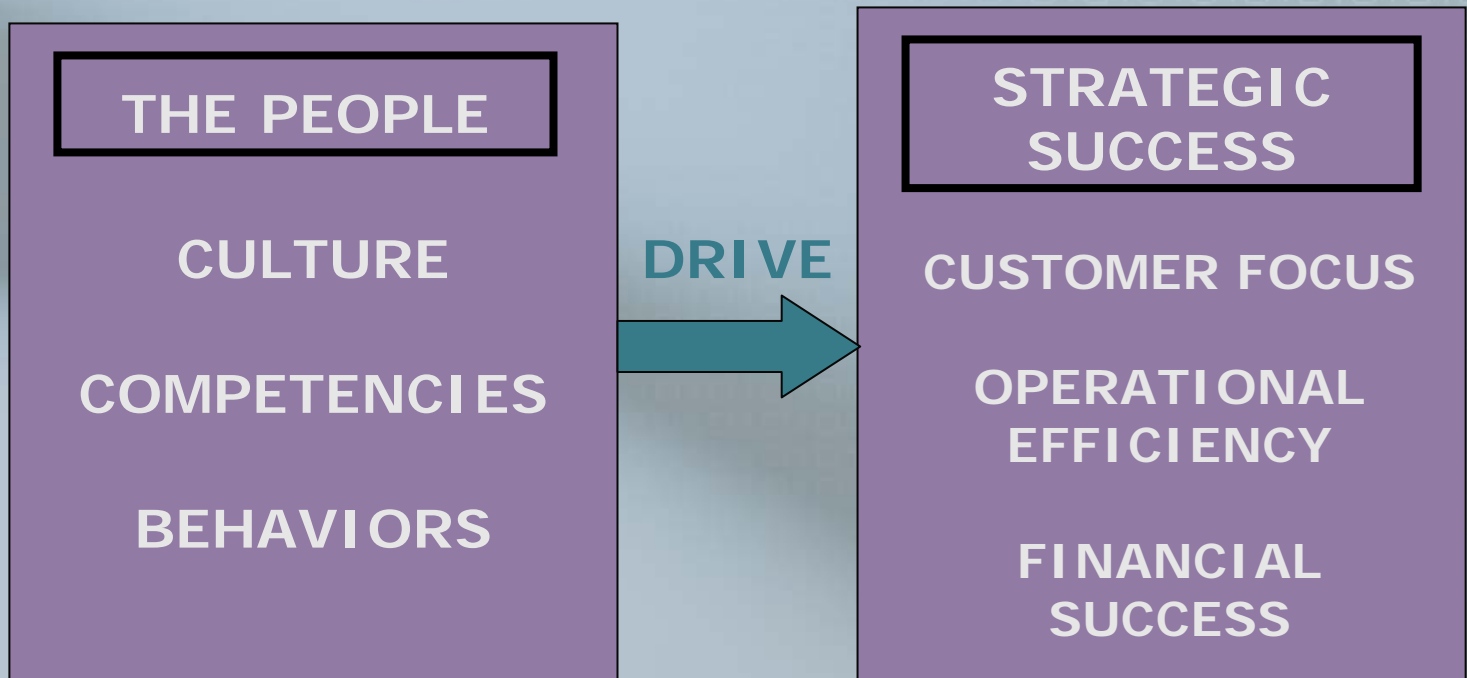
■ People (Big Picture)

- Individual institutions must take responsibility for this systemic and ongoing development of their most expensive asset – people.
- Boards of directors have a fundamental duty to ensure the ongoing viability of the organization – succession planning.



4. Think Strategically

□ People (Big Picture)



**It's the PEOPLE that
make the difference**

4. Think Strategically

- People - Change Our Thinking
 - Shift from:
 - This is a cost to be minimized
 - Biggest Expense Item - People
 - Cost Savings - Efficiency Ratio
 - Shift to:
 - This is the primary source of our differentiation
 - This is the best way (and perhaps the only way) to create shareholder value

5. Stay Out of the Tactical

“Regulators want us actively involved, executives don’t want us micro-managing, so what is the right level of involvement”

The best leader has the sense enough to pick good men, and the self-restraint enough to keep from meddling.
(Theodore Roosevelt)

- ❑ Staying out of the day-to-day running of the bank can often be difficult BUT it goes back to what the LAW expects of you.

6. Become GREAT Policy Makers

POLICY MAKING

- Policies around the strategic objectives.
- All functional and operational areas.
- Take into account Risk/Reward goals.
- NOT STATIC

LIMIT SETTING

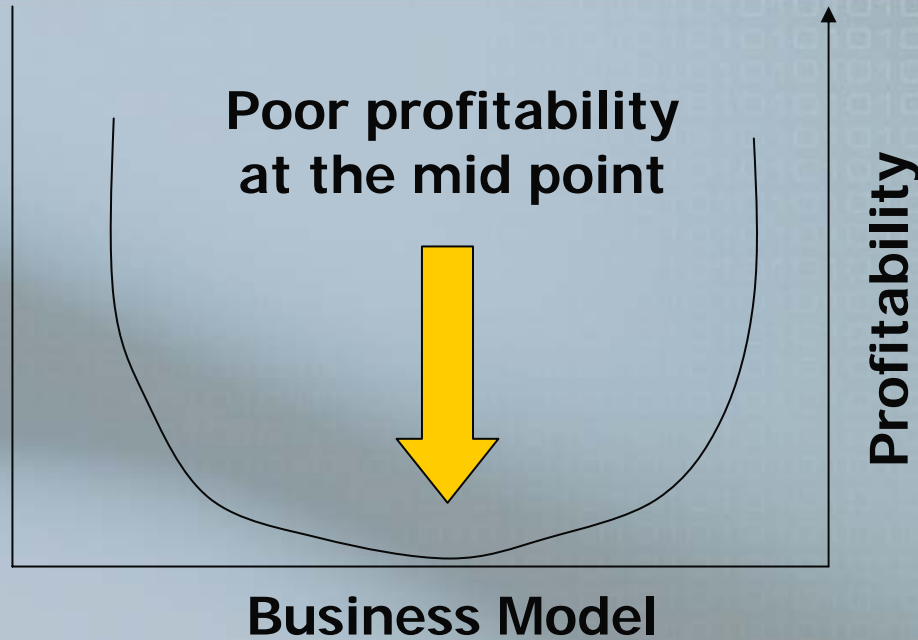
- Limits around policies allow control without micro-management.
- Limits provide senior management with authority to get on with the job.
- The board backs off.

7. Focus (Good)

Understand Your Competitive Stance (Value Proposition)

Differentiation	Creating something unique in the marketplace (product or service)
Price	Being the “low price leader” and doing high volume business
Focus	Focusing on a specific customer group, product line or geographic area. Specializing.

Focus (Good)



Focused/Specialty

- Unique product/service/customers
- Market perceives superiority
- Profits result from differentiation
- Strong margins

Commodity

- Little differentiation
- Substitutability
- Profits result from low prices
- Weak margins – **high volume**

7. Focus (Beware)

- ❑ FOCUS can also be fatal
- ❑ FOCUS is NOT:

- ❑ "We've always done it this way so we are ***focused*** on what we do best."

Even if you're on the right track, you'll get run over if you just sit there. (*Will Rogers*)

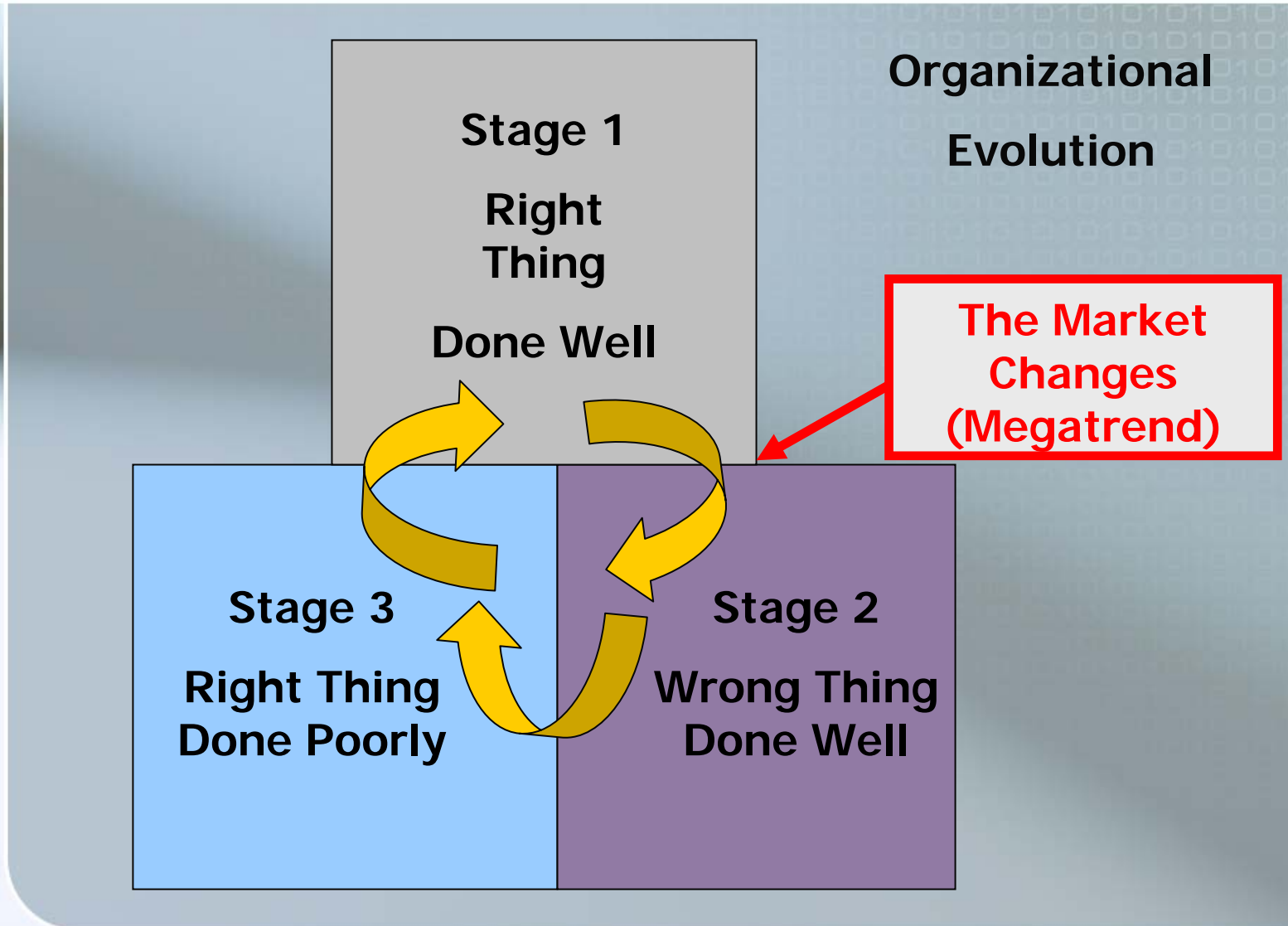
- ❑ "We know we are customer-focused because of our great survey results"

Click Here



[Focus Video Exercise](#)

7. Focus (Beware)



7. Focus (Beware)

❑ MEGATRENDS:

- ❑ Disintermediation
- ❑ Commoditization of Products
- ❑ Competitive Environment
- ❑ Changing Customer Needs



8. Plan

*“Let our advance worrying become
advance thinking and planning”*

– Winston Churchill



8. Plan

1. Strategic Planning	Major board involvement at the <i>appropriate</i> points
2. Tactical Planning	Limited board involvement – this is a management function
3. Contingency Planning	Limited board involvement – this is a management function
4. Succession Planning	Major board involvement at the <i>appropriate</i> points

8. Plan

Evolutionary stages of an industry...

Market	Developing	Growing	Maturing	Declining
Customers & Market Share	Few	Increasing	High Number but Stagnant	Declining
Competitors	Few	Increasing	Fight to Maintain Market Share	Exit of Some Competitors
Conditions	Product Focus Steep Learning Curve	Product Focus Fight for Market Share	Product Focus Compete on Cost (Commoditization)	Customer Focused

8. Plan

The most common reasons used to justify planning:

The *Ship Without A Sail* Analogy

The *Journey Without A Map* Analogy

But more to the point:

- 1. Our competitors are planning effectively and they are WINNING THE GAME!***
- 2. Research has shown a direct correlation between effective strategic planning and superior institutional performance***

8. Plan

**Use an effective
bottom-up
planning
process**

Bottom-Up
Planning
Vs.
Top-Down
Planning

Top-Down	Bottom-Up
BOARD	BOARD
↓	↑ ↓
MANAGEMENT	MANAGEMENT
↓	↑ ↓
EMPLOYEES	EMPLOYEES
↓	↑ ↓
CUSTOMER	CUSTOMER

8. Plan

“Directors who willingly allow others to make major decisions affecting the future of the institution wholly without supervision or oversight may not defend their lack of knowledge, for that ignorance itself is a breach of fiduciary duty”
(Joy vs. North 2nd Circuit 1982)

8. Plan

- Directors must be directly involved in the succession of their CEO
- Boards **MUST ALSO** be assured that a quality succession planning process is in place
- Demographics – As baby-boomers depart the workplace there simply aren't as many workers in subsequent generations.
 - Supply of “executive aged” employees will drop 15% by 2015
 - Requirement (given 2% annual economic growth) will be for an increase of 30%

8. Plan

- The “Millennium Elephant”
- The “old model” NO LONGER WORKS
 - The Old Model
 - Big banks as the training ground – (no more)
 - Community based organizations buy quality employees from those banks
 - Now
 - Community based organizations keep stealing each others employees and paying more and more for them

9. Commit

- Become & stay well informed
- Regularly attend meetings
- Act independently
- Face difficult decisions
- Participate *actively* and *knowledgeably*
- Question dubious situations
- Deal with management problems
- Represent the face of the bank in the community
- Undertake a well-defined business development role
- Exercise *sound* and *independent* business judgment
- Obtain* and *understand* all available information before making a business decision
- Be diligent and DOCUMENT that diligence
- Act like the owners that you are

9. Commit

❑ Commit to best practices in governance

■ Governance Committee

- Review Board Structure
 - Chairmanship
 - Independence
 - Periodic Board Effectiveness Evaluation
- Review Committee Structures
 - Audit
 - Nominating
 - Compensation
 - Directors deserve fair compensation

9. Commit

❑ Commit to best practices in governance

■ Governance Committee

- Develop New Board Policies
 - Non-executive director meetings
 - Independence requirements
 - Chairmanship / Lead Independent Director
 - Compensation – executive and director
 - New director search and nomination
 - Audit committee structure and responsibilities re. internal and outside audit
 - Director education
 - Age limits / term limits
 - Non-participation action
 - Board Succession

9. Commit

"Responsibility is a unique concept: it can only reside in a single individual. You may share it with others, but your portion is not diminished. You may delegate it, but it is still with you. Even if you do not recognize it or admit its presence, you cannot escape it. If responsibility is rightfully yours, no evasion, or ignorance, or passing the blame can shift the burden to someone else."

Admiral Hyman Rickover, US Navy.

10. Support Management

Governance is intended to be a system of checks and balance for management decisions. HOWEVER.....

- All the tenets of good governance rely on directors having complete trust in their CEO
- If you do not have that confidence it is your duty to do something about it
- If you lack confidence in your CEO and fail to act you are failing in the most fundamental responsibility of governance
- It is NOT productive to continue with an adversarial situation for any extended period

The Ten Essentials of Corporate Governance

1. Learn Continuously
2. Participate Actively & Intelligently
3. Question
4. Think Strategically
5. Stay Out of the Tactical
6. Develop Policy
7. Focus (in a good way)
8. Plan
9. Commit
10. Support Management



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