

What are your core principles?

By defining and adopting them, a board raises the level of its capability to focus on the big picture.

BY DONALD P. DELVES

IF A BOARD can demonstrate that it has adopted and operated by a set of core principles, that is strong evidence that it has exercised business judgment, operated in good faith, and exercised due care. That is essentially what William Chandler, then Chancellor of the Delaware Chancery Court, indicated at a governance conference hosted this past spring by Charles Elson at the University of Delaware Weinberg Center on Corporate Governance. Chandler, who retired in June after leading the influential Chancery Court since 1997, was part of a panel discussing the merits of a principles-based approach to the governance of executive compensation. In particular, the panel discussed principles developed by the Independent Directors Executive Compensation Project (IDECProject.org), and adopted by Best Buy Co. Inc. and other companies. The current chair of the Best Buy HR and compensation committee, along with Best Buy's former CEO and prominent members of the institutional investor community, were also on the panel.

Chandler's positive response is not an endorsement of any specific set of principles, but is a strong indication that boards should develop, define, adopt and operate by core principles that capture their essential responsibilities. It is far too easy for a board to get bogged down in regulatory compliance and lose sight of their broader oversight roles.

Principles can help a board re-orient to its higher purpose of serving the long-term well being of the enterprise and its constituents. Orienting to principles by asking "how are we operating by this principle right now?" can help board members guide difficult discussions and debates on a range of challenging issues, from strategy to acquisitions to executive compensation.



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Some core governance principles and brief definitions are as follows:

- *Stewardship* reflects a board's long-term responsibility to the enterprise and the relationship of the enterprise to its constituents. Most board members will see two or three management teams come and go. Hence, the board's responsibility goes beyond any specific set of strategies and must incorporate the overall purpose and mission of the enterprise.

- *Purpose* includes the company's mission, vision, values, culture, strategy and objectives. It is why the company exists, but also what the company aims to accomplish in the world.

- *Accountability* is the glue that holds the enterprise together and assures its healthy functioning. Management is accountable to the board, which, in turn, is accountable to shareholders and possibly other stakeholders. Employees are accountable to management. Management uses accountability as a primary tool for running the company, but it is the board's job to make sure that core accountability systems and reporting are

functioning well.

- *Engagement* captures the basic life force of the organization — the motivation, focus, direction, excitement and intensity that animate its people toward a common vision, strategy and objectives. This is the domain of all employees and managers, but the board has a responsibility to make sure that a company's human capital is fully engaged through effective employee development, leadership, compensation, and succession planning.

- *Alignment* is the principle that captures the critical connection between the interests of shareholders and those of management. Are executives aligned with shareholders? Are employees at all levels aligned with the strategy and purpose of the organization? Is there proper alignment between business units and geographies? These all are important questions for board members to address.

Most boards would probably include some principles from this list. These principles are universal concepts that have significant meaning to most people, and can be used to raise the level of boardroom dialogue to focus on the big picture.

Once a board develops its core principles, the next step is to define criteria for each principle. These criteria can then be used as a basis for evaluating the board, its committees, or specific areas like executive compensation. Best Buy and other companies have used core principles to evaluate their executive compensation programs, and have published their principles and criteria in their proxy statement.

Boards have been given broad leeway by the courts in executing their jobs. The business judgment rule has been applied leniently to give boards significant discretion and flexibility. This is appropriate, but it is also incumbent on boards to explicitly define the core principles by which they operate, and to be able to demonstrate to themselves and their constituents how well they observe and orient to those principles. ■

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