Governance Notes

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The Difference Between Governance and Management

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Fundamental to the effectiveness of the board/executive officer dynamic is a shared understanding of the basic distinctions between the roles of governance and management. Basic aspects of the respective roles are set forth in state corporation law, and helpful position descriptions are the subject of much attention in governance guidelines prepared by leading public policy organizations.

But it would be far too convenient to conclude that the line separating the responsibility of the board and the responsibility of management is clear. Rarely has it been in the past, and it certainly is not the case currently. The absence of a "bright line" separating these responsibilities can be the source of much leadership-level friction unless different perspectives can be accommodated. This article looks at what the law and governance principles say distinguish the roles of governance and management, and highlights the need for these two groups to work together to ensure a positive relationship.

What the Law Says

Most modern state corporation codes make it clear that the ultimate authority for corporate affairs lies with the board of directors. At the same time, they typically provide that the board may delegate the responsibility for the management of such affairs to competent executive management. For example, the Illinois General Not-for-Profit Corporation Code provides:

> "Each corporation shall have a board of directors, and except as provided in the articles of incorporation, the affairs of the corporation shall be managed by ***or under the direction*** of the board of directors."

The Model Nonprofit Corporation Act (Third Edition) approaches the matter in a similar manner:

> "…the activities of the corporation must be managed by or under the direction, *and **subject to the oversight of***, its board of directors."

This statutory approach provides flexibility for the board to either delegate management responsibilities (which is the case with most sophisticated corporations), or to actually run the day-to-day affairs of the business (which is the case with some smaller non-profits). Nevertheless, delegation of management duties to executive employees is subject to the board's ultimate authority and responsibility. The language I've italicized in both the Illinois Code and the Model Act is intended to underscore that fundamental obligation. The nature of the oversight is expected to vary depending upon the nature of the organization's activities, but the law is increasingly likely to hold the board of an operationally and financially sophisticated non-profit corporation to essentially the same standards as it does to the board of a public company.

What Governance Principles Say

Beyond state law, recognized governance principles promulgated by respected public policy and related organizations often provide the best reference from which to distinguish the duties of the board from the duties of management. Some of the most prominent statements of principles are those prepared by the Business Roundtable, the Commonsense Principles of Corporate Governance, The Conference Board, the National Association of Corporate Directors, and the American Bar Association.

The Basics

At its most fundamental level, the expectation is relatively simple. As the Business Roundtable suggests, in the exercise of its oversight role the board is expected to approve corporate strategies intended to support

creation of long-term corporate value and sustain the organization's purpose and mission. While directors are expected to be fully engaged in the attentive oversight of corporate affairs, they are not called upon to manage (or "micromanage") these affairs by either performing tasks traditionally assigned to executive leadership or duplicating those tasks.

Management, on the other hand, is expected to develop and implement corporate strategy and manage the day-to-day affairs of corporate operations subject to board oversight, for the purpose of supporting mission sustainability and long-term value.

The Specifics

The governance principles go further, to varying degrees, in articulating more specific roles and responsibilities of the board and management.

As to the board: there is general acceptance (see, e.g., the Business Roundtable and the American Bar Association guidelines) that the board's oversight duties include at least the following responsibilities, if not others:
- Selection and evaluation of the chief executive officer
- Establishing the ethical "tone at the top"
- Ensuring the effectiveness of the corporate compliance and enterprise and risk management programs
- Approving the development of a strategic plan, ensuring its implementation, and monitoring its continued effectiveness
- Ensuring the integrity and transparency of corporate financial reporting and performance-related disclosures
- Monitoring reputational risks, exercising material authority with respect to the capital allocation process and strategy
- Oversight of the preparation, and approval, of annual financial plans and budgets as prepared by management (and subsequent monitoring thereof)
- Implementing periodic full board and individual director evaluations
- Material involvement in the establishment of board agendas, developing internal governance processes and protocols, recruiting and retaining directors, pursuing formal executive succession and talent development efforts, and directing crisis management activities

Of course, healthcare boards have additional accreditation and other responsibilities around quality of care.

With respect to these core duties, the board is entitled to receive periodic education on the company and its industry, should minimize the amount of time on "frivolous or non-essential matters" (per the Commonsense Principles), have unfettered access to members of the senior leadership team (including those who report directly to the CEO), and should meet periodically in executive session without the CEO (but regularly with the general counsel in attendance).

As to executive management: there is general acceptance (see, e.g., the Business Roundtable) that executive management's duties include at least the following responsibilities, if not others:
- Operate the day-to-day management of the company, subject to board supervision
- Develop and implement the company's strategic plan, with the involvement and monitoring of the board
- Make recommendations to the board with respect to capital allocation
- Maintain the corporate compliance program
- Identify, analyze, and respond to enterprise/operational risks
- Prepare for board approval accurate and transparent financial statements and other operational disclosures
- Develop annual operating plans and budgets for board approval (supplementing such plans and budgets as circumstances warrant)
- Select qualified management and establish an organizational hierarchy
- Work with the board in executing material talent development and succession initiatives
- Develop organizational crisis management procedures

Relationship to Corporate Responsibility

The 15th anniversary of the enactment of the Sarbanes-Oxley Act, and the corporate responsibility environment it prompted, provides an additional perspective from which to evaluate the roles and relationships of the board and executive management. Because, in a very real sense, that's where it all began—the seismic recalibration of corporate direction from the executive suite back to the board,

where it belongs. The act birthed the fiduciary guidelines, principles, and best practices that serve as the corridors of modern corporate governance, developed in direct response to the problematic conduct of the boards of Enron, WorldCom, and other controversies of the time—and similar controversies still exist to this day.

According to the American Bar Association, corporate directors are expected to serve a key role in overseeing the conduct of the senior executive leadership team. In order to perform that function effectively, boards must avoid being compromised by undesirable realities of the board/executive relationship (particularly the CEO). These include:

- Being overly dependent upon, and overly passive with respect to, senior executive leadership
- Conversely, allowing the senior leadership team to view directors as a "sounding board," but not as individuals who are to be encouraged to push issues or independently raise "yellow" or "red" flags
- Relying almost exclusively on the senior leadership team (and advisors they select) for information and guidance on corporate affairs
- Being unwilling to devote adequate time and attention to their oversight responsibilities
- Too often deferring to the senior executive officers to perform important tasks such as setting board meeting agendas, selecting board nominees, initiating the analysis of and thus essentially establishing executive compensation, selecting key board and committee advisors, and selecting the outside auditor
- Allowing outside advisors to view the senior executive team, rather than the board, as the ultimate client

Special Note About the Relationship

One of the most important—yet least understood—aspects of the board/management dynamic is the responsibility of the board to foster a positive relationship with the CEO. This includes being supportive of management's appropriate efforts to pursue informed risk-taking and encourage the long-term sustainability of the corporate mission.

Since the enactment of the Sarbanes-Oxley Act, much has been made of the board's responsibility to engage with senior management on the basis of "constructive skepticism" and an active, independent oversight role. That's completely appropriate, but that does not mean that the board/management relationship should be adversarial in order to ensure corporate responsibility. An overarching responsibility of the board is to support the collegiality of the board and its committees, and the relationship between the board and management whenever possible.

Projecting Forward

While there are many elements of the board/management dynamic for which there is general agreement, the constant evolution of regulated industries, such as healthcare, as well as the increasing implications of business disruption, will always provide fodder for future conflict on roles and responsibilities. In these circumstances, it is possible that both the board and the management team may seek to assert additional authority. Given the nature of such circumstances, it's likely that both sides are right. It may well be that more board involvement with these developments is beneficial, but only exercised with great sensitivity to the proper role of management.

So where emerging trends and developments create the potential to alter the traditional governance/management dynamic, the board and management should "team" cooperatively to ensure that such alteration does no harm to that dynamic. This will require thoughtful communication as to why each group feels these new challenges require their particular attention.

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