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News, Articles, and Updates

The Move Toward an Activist Board

This is the first article in a series examining the role of the board following the wave of industry consolidation.

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A combination of developments may be pushing healthcare boards toward a more active role in corporate affairs. These include the fundamental change in the healthcare financing system, the rapid consolidation of the non-profit healthcare sector, dramatically increased physician integration, service line diversification beyond traditional care delivery models, and the recruitment of new board members with specialized competencies and unique expertise. These are seminal matters that can prompt a heightened level of board attentiveness.

Add to all of this an increased willingness of regulators (and the media) to raise the "where was the board?" question in times of corporate controversy—prompting subtle new concerns with the appropriate standard of fiduciary conduct and, indirectly, with individual liability exposure. The cumulative effect of these developments is, increasingly, a board that is less passive, less reflexively deferential, and more motivated to become actively engaged in corporate affairs.

This goes beyond enhanced boardroom attentiveness, toward a more pronounced assertiveness with respect to the broader corporate agenda: a tighter leash on senior leadership, a "hands-on" approach to strategic challenges, more direct involvement in care and risk management, a sharpened boardroom culture of constructive skepticism, and a willingness to intervene to resolve ethical lapses, compliance exposure, and reputational harm.

This is not necessarily a bad thing, if managed properly. Indeed, a major emphasis of the post-Sarbanes-Oxley "corporate responsibility" environment has been to ensure an enhanced role for governance in the oversight of corporate affairs and of management's conduct. The regulatory emphasis on compliance is built on a "tone-at-the-top"-based foundation. Governance best practices are the focus of renewed boardroom attention. Rare is the non-profit health system board that has not embraced these core principles. The days of the "imperial CEO" have mostly passed.

This trend appears consistent with the increased oversight requirements of a more diverse business portfolio. The quality of board diligence must improve if it is to keep pace with the governance demands of the more operationally and financially sophisticated health system. In many respects, the more active, assertive, and aware a board is, the more responsive it is to the governance needs of an evolving healthcare sector.

But this type of board can also be a very bad thing, if not handled properly. Certainly, these new developments help foster an impression that boards must be much "closer to the action" in order to be truly effective—that greater engagement is a reliable prophylactic for personal liability—but it is a perception that is not entirely accurate. The shift toward a more active governance model carries with it the potential for altering, in a negative way, the traditional governance/executive dynamic. When the lines between governance and

management are blurred, operational professionalism may suffer and critical checks and balances may weaken.

The warning signs of excessive activism by the board (or by its leadership) may include the following: taking the predominant role in developing the board meeting agenda; increasing the board reporting obligations of corporate officers; becoming directly involved in transaction negotiations; directing major components of the strategic plan; engaging advisors to represent the interests of the board on a regular basis; maintaining direct contact with corporate vendors, constituents, consultants, and strategic partners; serving as primary organizational spokespersons; and assuming an executive role on an interim basis (e.g., upon the departure of the CEO or CFO).

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Rather than reacting to management recommendations on strategic or policy matters, the board is proactively participating in the formation of those recommendations. Rather than exercising oversight of management's pursuit of individual initiatives, the board is directly involved in the identification and implementation of those initiatives. Rather than utilizing the expertise of advisors recommended in good faith by management, the board retains a parallel set of advisors.

Yet, there is a very fine line between conduct that suggests excessive activism and that which can be fairly characterized as attentive governance. Oftentimes, the risk arises not from individual actions but rather from a pattern of conduct by which the board, acting in good faith, interjects itself more directly and consistently in executive-level tasks. When it does so, it can undermine the effectiveness and credibility of senior management, decrease the quality and effectiveness of the management function, erode governance checks and balances, and increase board members' exposure to personal liability.

There's no question that expectations of healthcare governance will increase with the dramatic consolidation of the sector. The pronounced concentration of control in larger community, regional, and national systems and the shift toward greater operational diversity will by necessity increase expectations of boardroom conduct. The board that is sensitive to this and similar trends will naturally feel a gravitational pull toward more active, hands-on leadership.

Identifying the appropriate level of board engagement in a changing and consolidating healthcare sector requires the conscious and committed discernment of both the board and management. They have to talk it through. Acting with the support of qualified facilitation and on the legal advice of the general counsel, these organizational leaders should carefully reevaluate their respective roles in the context of industry realities, organizational mission, and governance law. Such an evaluation process should include a review of the following:

- **Traditional roles:** The starting point of any evaluation is to revisit the traditional role descriptions of the board and the senior leadership team, and the fundamental distinction between governance and management. Basic to this is the statutory concept that the business of the non-profit corporation is managed under the direction of the board. However, directors aren't well positioned to manage the corporation directly and comprehensively. For that reason, they are authorized to delegate day-to-day management responsibilities to qualified executive management. The board must then exercise oversight of executive leadership. Implicit in this delegation is the board's ability to rely on the advice of its leadership team.

  Law and best practice specify particular duties for the board in its oversight role. These include the following core principles: 1) selection, compensation, and evaluation of the CEO and related succession planning; 2) overseeing the strategic planning process; 3) comprehension and approval of annual budgets; 4) confirming accuracy/clarity of financial statements; 5) ensuring consistency of operations with non-profit mission and tax-exempt status; 6) advising executive leadership on important issues confronting the corporation; 7) rendering informed decisions on major corporate actions; 8) ensuring operation of an effective corporate compliance and ethics plan; 9) nominating qualified candidates for board and committee positions and ensuring comprehensive director education and self-evaluation protocols; and 10) authorizing the exercise of reserved powers

over corporate affiliates as may be established in governing documents or statute. Note that none of these responsibilities directly involve the board in day-to-day management.

- **New pressures:** There must be a shared sense of the challenges confronting the board, and executive management, respectively. Only from that basis can there be a true sense of appreciation and understanding of the perspectives that each brings to their roles. For example, senior management should be sensitive to board concerns arising from the responsibilities of oversight, the exercise of business judgment, specific community health needs, keeping pace with the rapid rate of change in the healthcare sector, and the risk (however attenuated) of personal liability exposure. On the other hand, governance must be sensitive to the pressures on management to operate a very sophisticated business enterprise in a highly regulated industry that is in the throes of a monumental change in the manner in which the organization is paid for its services.

  Certain challenges have the potential to create particular board/management conflict; e.g., strategic planning (including major corporate transactions), physician integration strategies, executive-level performance and compensation, compliance plan effectiveness, and risk management strategies and investment management practices. Perceived new fiduciary and compliance pressures could (and maybe should) prompt the board to exercise levels of diligence and inquiry to which management may object, as an encroachment on their authority.

- **Reporting requirements:** There should be a general agreement of the nature and frequency of reporting relationships between senior leadership and the board. Fundamental to such an agreement is an understanding of what is required by law, best practice, and professional ethics. Also important is an understanding that, with respect to certain key positions (e.g., the chief financial officer, chief compliance officer, and general counsel), the law expects a dual reporting relationship—to both the CEO and the board. At the same time though, there should be an understanding of how to structure governance reporting requests so that they are not burdensome to management, a distraction from core responsibilities, or do not work to circumvent the basic authority of the CEO.

- **Information and approvals:** There should also be agreement on the quality of information the board receives from management, and the frequency with which it is received. Again, this requires a delicate balance between that which is reasonably necessary to support informed board oversight and action, and that which is excessive and more consistent with a management-level role. Along the same lines, there should be agreement on matters that the CEO may pursue without board involvement, matters that the CEO can pursue with notification to the board, and matters that the CEO can pursue only with board approval.

A thoughtful, substantive dialogue between the board and the executive leadership team offers the opportunity to clarify the proper roles of governance and management in the context of a rapidly evolving non-profit healthcare sector and the operational and fiduciary demands of a sophisticated healthcare system. The guess here is that these circumstances will lead to greater board engagement on all aspects of the corporate agenda, as a new standard of conduct. But greater engagement must be coupled with guidelines designed to protect against unwarranted intrusion into the executive suite. If the "property line" between governance and management requires a new "survey," great care should be given to the location of the "boundary stakes."

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