# HOW BOARDS AND MANAGEMENT CAN WORK BETTER TOGETHER IN TOUGH TIMES

Tough times may cause a tug of war. Wouldn't it be better if everyone pulled in the same direction?

You can submit your own comments on this in the comment area that follows this article.

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Through our field work with dozens of boards in the post-crisis atmosphere, we're witnessing a new variety of board-management tug of war. Directors are worried about unforeseen risk and what the future may or may not bring, plus the imminent uptick in regulatory scrutiny. Management is reactively digging in its heels under perceived or real "micromanagement."

What's most troubling is that these destructive tensions are characteristic of healthy and struggling banks alike.

The following anecdotes map out the current crossroads the industry faces. While the catalysts are economic, and the realities of loan performance, capital adequacy, and profitability are harder than ever, the real threats are the words not said, the assumptions made, and an increasingly debilitating environment of fear, mistrust, and uncertainty.

We hope, through these examples and the suggested solutions that follow, to ease this situation.

Case 1: The Bank with Credit Issues

Imagine a bank rocked with credit issues-struggling against loan losses, liquidity concerns, and regulatory scrutiny. The board no longer has any confidence in the management team. The directors feel that they stand alone in the battle to correct the downward trend. To exacerbate the problem, this mistrust and micromanagement is being led by the retired CEO, who is not only on the board, but has taken over the loan portfolio. Frozen between dealing with regulators and a perception of management's shortcomings, the board is assuming that it can fix the issue. Communication between the two sides has stalled and turned contentious. They are not moving forward; rather, they are stuck in the past.

Case 2: The High-Performing Bank

A bank with a high-performing credit portfolio and a proven, capable management team is being second-guessed by its board. Even though the bank's credit performance has been stellar during this time period, the board believes the results have been doctored; that the management team is downright hiding the real problems; and that it is only a matter of time before the next shoe drops. This bank is being torn apart because of board-management suspicion and no future focus on growth.

Case 3: The Seemingly Successful De Novo

What about the de novo that has gained customers fleeing mega-banks in search of safety and soundness? You would think this prosperous beginning would be received with joy and optimism for the future. Upon closer evaluation, you see that the success thus far has been created based on circumstance, not the management team's prowess. The directors feel the management team is overly conservative, averse to growth, and making decisions outside its strategic comfort level. This has sparked open friction, a culture of second- guessing, and increasing board-management mistrust.

What's missing in these cases? To one degree or another, communication. If you see your bank in the above anecdotes, or if you are among the many banks that have been "hunkered down" dealing with problems, do not waste another minute. Carve out a strategic plan for your future now. Align your board and management team through planned communication to better understand the issues at hand.

How do you "plan" communication?

Led by the CEO or Chairman of the Board, planned communication should be a specific, written component of your strategic plan and it should be customized to address your bank's specific issues. The alignment of your communication goals with your strategic plan is a critical step, as one could argue that most banks' strategic plans are out of date, perhaps seriously so. This financial crisis has shown that a renewed or totally revamped strategic plan is paramount to success moving forward.

1. Start by asking questions. Explore alternative means to gather this feedback. Current concerns may cause people to be reluctant to openly share what's on their minds, without prodding. Think about developing a questionnaire for directors

and the management team. For best results, keep it anonymous.  For example, you may ask:

a. What specific problems, real or perceived, are plaguing our bank?

b. Which issues are impeding you as an individual director or management team member from addressing a solution to the problem at hand?

c. What is your desired outcome of this issue?

d. How would you recommend addressing this?

e. Does your recommendation line up with your desired outcome and will it successfully add value to the institution?

2. Lay out the "who, what, and where."  Each board meeting should allot time for open discussion. The chairman or CEO should lay out the objectives of this exercise; facilitate the creation of the list to address; and schedule special meetings as needed to allow the participants to work on particular issues.

Historically, this has been an impetus to an "executive session." We believe these sessions are a valuable method for approaching board-specific issues. It is also a vehicle to achieve board consensus on troubling issues in the implementation of strategy, as well as an awareness of any knowledge gaps that exist.

The main issue with a closed session like this is in the intention of the meeting. From a management perspective, such meetings can come across as "club house" or "secret society" gatherings. They can be seen as an occasion meant to question management; make decisions on issues without the guidance from the management; and micromanage its implementation. The key is to be clear on the agenda upfront; to ensure outside members understand the breadth and scope of any decision making; and to quickly regroup with the members at large on the outcomes.

Transparency yields open communication and swift results.

3. Make it specific! After you have solicited feedback, you may uncover numerous issues. Don't be vague on any topic. The more specific you are on the problem, the more likely you are to come to a resolution based on integrity and consensus. Schedule any meetings to allow adequate time to delve into each issue. Over-scheduling the agenda will lead to a rushed consensus or frustration over no resolution. Other issues can always be placed on the back burner for future review. It is important that this process be driven by a well-defined expectation of what it means to successfully come to a resolution. If you don't know what the end product is to look like-you won't know when you get there.

The earlier de novo anecdote is a great example of how not having a well-defined expectation of future value can impede the communication process. For the board and management at that institution, a concise, well-defined list of issues and concerns has broken down walls and moved them to rapid consensus of what needs to happen to move the bank forward.

4. Education leads to clarity. When dealing with subjects brought about by misunderstanding, integrate education on the issue to develop a better grasp of the severity underlying the topic. Additional knowledge often brings about a broader understanding and clarity to any resolution. Consider incorporating expert knowledge into the mix, in addition to distributing articles or Internet links. How many times have you heard bankers say, "When an expert speaks to our board, no matter how many times management has said the same thing, suddenly the board gets it!"

As with the high-performing bank anecdote, a full understanding of what metrics are used to determine the strength of the loan portfolio and how those metrics line up against peers in both the loan loss and risk perspective led to a rapid resolution and an immediate diffusion of any mistrust. Utilizing the outside peer analysis that confirmed management's results was all that was needed to put this to bed.

5. Document the results. The discussions conducted and any action plans which result should be documented and kept within the board minutes. This is not only useful to keep the regulators informed, but will allow the program to be tracked efficiently. Although you don't want to tediously document every step of the process, a results-based approach is beneficial. In our first example, the regulators were very pleased to see that the board and management had collectively identified the issues that had risen to the top of their credit challenges. Further, their documentation of what results were expected to achieve success and how they have gone about gaining that success through assessment, communication, and action spoke volumes on how the bank would work their way out of the greater problem at hand.

What should you "plan" to talk about?

Planned strategic communication should choose issues that promote thought and active participation by all those involved. The discussions should be designed to put "meat on the bone" and provide the opportunity to create actionable items to improve the viability of the bank. Consider the following topics:

1. Capital. Whether your bank has too little or too much, regulators want every bank to have a capital plan. Adding this to the fact that most bankers believe that increased capital requirements are on their way, capital adequacy is an excellent issue to explore as a group. Management should prepare long-term models of the bank's balance sheet and income statement to exemplify the ramifications of different scenarios for the directors. The group can then delve into and examine future dividend plans, growth implications, and the correct mix of deposits and loans to sustain this growth.

2. Credit risk. Right now, as we see the end of the credit cycle approaching, is the best time to assess the credit risk you have taken. This should not be a witch hunt, but should be designed to allow the management team and the board to review what went right and what went wrong. Further, conversations on how credit risk can be better managed in the future should include the changing mix of loans, loan policy adjustments, and a timeline of any changes.

3. Liquidity. Many banks have seen significant changes in their deposits and borrowings due to the financial crisis. There are numerous opportunities for community banks in this post-financial-crisis environment. The mistakes made by the competition still yield dissatisfied customers that can be attracted to your institution. With core deposits at an elevated level, what actions are being taken to understand and capitalize on the liquidity implications in retaining these relationships as the financial environment shifts?

4. Value creation. With the decline in stock values that have plagued most banks, everyone is wondering whether or not true value will ever come back. Even private, not publicly traded banks are reputationally hurt with the same value disintegration assumption. This pessimism is a source of angst and should be discussed openly. What will be the bank's value in the future? What will drive that value? What can we do today to promote the value of the bank?

In tandem with the suggested topics above, there should be regular reporting of how the actions taken have actually worked. This will then promote continuing discussion on issues and determine whether renewed focus is warranted.

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