

Corporate Governance

MY PERSPECTIVE SERIES:
REPRESENTING THE AUTHOR'S
PERSONAL PERSPECTIVE

Firms are clearly able to adapt to changing conditions successfully when a responsible board is doing its job.

by Louis L. Marines

Enron. Liz Claiborne. Lehman Brothers. AIG. BP. The roster of firms whose boards have failed them, or even driven the companies under their care out of business, grows every year. While the titanic crashes of major financial, product and oil companies may seem distant from the world of a typical engineering, architecture or construction firm, the A/E/C industry is just as vulnerable as other businesses to the flaws that plague boards of directors around the world.

I look around the industry and see firms whose board seats are more of an honorarium than a working directorship, some whose board chairperson is also the firm's CEO, and yet others whose boards may fulfill one role successfully (overseeing risk or leadership development) but lag in other important areas.

In this series of articles in the 2011 *FMI Quarterly*, I will address the responsibilities of boards of directors, what the relationship with the CEO should be, and how a board can best ensure success for the firm.

MARKETPLACE ALIGNMENT

Boards must take oversight of the firm for both the short and the long term.



The primary responsibility of the board is the immediate and continued health of the firm, including financial performance, operations, risk, strategy and CEO oversight and compensation. Failing to align the firm with changing marketplaces and their needs and opportunities is the reason firms fail. Too many boards blame the market or excuse the CEO, when it is their job to ensure that the firm is led by an entrepreneur who can adapt the company to thrive versus riding it down the hill to oblivion — or selling/liquidating before there is nothing left but smoking embers. If the board cannot get performance, risk, strategy, succession and oversight right, nothing else matters. In 2009 Paul Zofnass, president of The Environmental Financial Consulting Group Inc., reported at the annual FIDIC Conference that out of 31 of the top design firms in the U.S., 52% (16 firms) had gone bankrupt or been sold; 23 of the 31 firms, or 74%, had undergone a major ownership change.¹ How many other firms have closed their doors in the past three years? Their boards have failed them.

IS THE BOARD ITSELF A RISK?

When the board looks at the near future, it must consider what risks are present and how the firm should handle them. If the firm cannot handle those risks, the board must evaluate what competencies or processes are needed to manage those risks. Among these risks are the board's own composition, relationship to the CEO and behavior. As reported in the *Harvard Business School Alumni Bulletin* of June 2010, when Lehman Brothers failed in September 2008, only one of the 10 nonexecutive directors had any recent banking experience.² The other nine were from unrelated fields, and according to Bryan Burrough and John Helyar, authors of *Barbarians at the Gate (1990)*, had been handpicked by CEO Richard Fuld on

the basis that these individuals would not challenge him. Among the board members were a retired rear admiral who had previously headed the Girl Scouts; a retired art auction company executive; and 83-year-old actress Dina Merrill, who filled a seat on the board for 18 years, and as a member of the compensation committee, rubber-stamped Fuld's \$484 million salary, stock options and bonuses from 2000 to 2007. Ms. Merrill, in spite of being the daughter of E.F. Hutton and Marjorie Merriweather Post, was unqualified to understand the complexities of credit default swaps or the dangers they posed.³

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OPERATIONS AND STRATEGY

A responsible board must consider how and whether the firm's operations match up with its strategy and needs.

The board must ensure that the company's talent and capabilities are aligned to the client needs that the strategy says it will address and are constantly being developed, so the response to clients remains current and advantageous. The staff must be engaged with the firm and rewarded. Project delivery mechanisms must be aligned with the strategy; consultants and subconsultants must be chosen to leverage the strategy; and pricing must be consistent with the strategy. The board must see that internal feedback systems are in place to ensure consistency in operations, practice and learning; provide quality assurance; and leverage good ideas.

The firm's strategy for the future should be a primary concern of the board and under constant evaluation:

Is the firm drifting away from the stated strategy? Is the strategy still serving the organization? Do changing conditions require a shift to one of the

alternate or emergency strategies? A company should have a primary strategy for gaining work now and contingent strategies that prepare it to respond rapidly when conditions inevitably change. Every firm should develop an emergency strategy for operating during disasters and unexpected problems.

For many years, the strategic focus of Liz Claiborne clothing was to provide high-quality, well-designed women's clothing through high-end department stores. The firm was an astonishing success, with Ms. Claiborne becoming the third female CEO to reach the Fortune 500. With this success, the board led the company into aggressive expansion, opening a chain of company stores and adding a large number of other lines. In 1989 Claiborne and her husband, Art Ortenberg, retired from active management of the firm and the decline began. The board's chairman chose the strategies of making acquisitions and producing cheaper clothing, but his strategy backfired. The brand became confused and diluted while profits and share prices dropped steadily for the next decade, yet the board continued to pursue the failed strategy, compensating themselves and CEO William L. McComb as though they were successful. In August 2010 the firm reached a new nadir, announcing that the Liz Claiborne brand would be turned over to J.C. Penney for the next decade. By choosing a poor strategy and following it relentlessly into a downward spiral, the once-proud brand has been ruined.

THE BOARD AND THE CEO

The Liz Claiborne board also failed to oust a CEO whose leadership has been disastrous. McComb and the board members are highly compensated in spite of their failures, yet CEO oversight and compensation are key responsibilities of every board of directors. Many boards have felt the wrath of both stockholders and the public over the obscenely high compensation received by CEOs, who were complicit in creating the current worldwide financial crisis. Holding the

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CEO accountable for his or her leadership and managing that CEO's compensation accordingly should be a particular focus for every firm's board.

The board also has key long-term responsibilities: CEO succession, watching the horizon for future direction, leadership development, corporate social responsibility and board succession.

It is a major responsibility of every CEO to identify and prepare a future successor. The board of directors should take a key role in helping the CEO with

this task. Larger firms may want to prepare several people with different talents, so that when the time comes, a CEO with the abilities best-suited for that time will be available.

During an economic crisis, a more management-oriented CEO might be chosen, while during an economic boom, an entrepreneurial individual would be the best choice.

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SCANNING THE HORIZON

The board is responsible for the firm's current strategy and for doing what the CEO may not have time for: watching the horizon for changes that indicate future direction and determining possible long-term strategies. Understanding how trends will play out over time is both

challenging and time-consuming, but with technology, economics, demographics, politics, environmental and other factors changing at an ever-more-rapid pace, this watchtower function of the board and CEO must be constant. New tools for creating more robust and flexible strategies and contingencies are now available for engineering and architecture firms, such as the scenario planning process and the A/E Future Scenarios developed in 2009 by FMI. Scenarios offer a look at how current trends could play out in alternative futures, and help firms determine how those futures will affect the marketplace and what strategies will be most effective under different circumstances.

LEADING SOCIAL RESPONSIBILITY

Another major responsibility of the contemporary board of directors is in leading the social responsibility efforts of the organization. Taking action to contribute directly to the firm's community, to address environmental concerns and to exhibit leadership in both areas is no longer optional. Corporate social responsibility is now a fundamental need for every firm, and done well, it reaps many benefits that include:

- Building a stronger community creates a more robust market for the firm's services.

- Giving employees opportunities to take direct community action builds engagement and loyalty.
- Incorporating sustainable materials, energy efficiency and smart building features into every project has positive long-term effects for coming generations and can give clients immediate financial value.
- Aggressively advocating for sustainability and environmental responsibility positions the firm in a leadership role. Aggressive advocacy may also include refusing to take on projects that violate the firm's green/sustainability principles.

In October 2010, *Architectural Record* published a feature article about New Songdo City in South Korea, an entirely new city being “built from scratch” near the Incheon International Airport, incorporating U.S. LEED design standards, which are new to Korea. However, the article reports that the city lacks “a viable downtown where people do business” and that “the townscape seems under-inhabited.” In a letter to the editor published in the December 2010 issue, Diane Elliott Gayer, AIA, says of the project that after visiting the site, “Creating 1,500 acres out of tidal flats and estuaries is anything but green, especially when developed solely on spec... Instead of the question raised in the article of ‘How will it finish?’ I ask, ‘How did it start?’ and ‘What is our responsibility as architects, urbanists and planners to the health of our planet beyond the adoption of declarations and certifications?’”⁴ The board should take responsibility for guiding the firm in manifesting social responsibility and be aware of the risks involved in saying one thing but doing another.

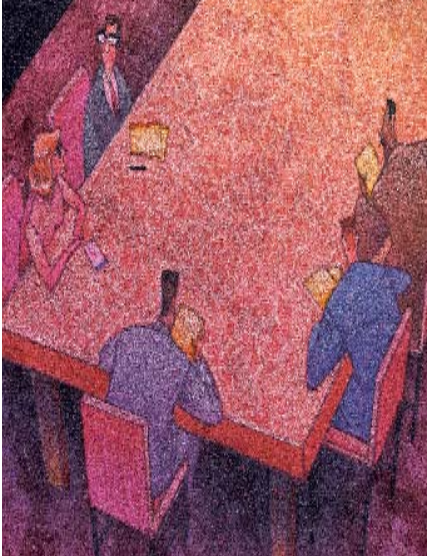
WHEN BOARDS DO THINGS RIGHT

Psomas Engineers has a sustainability declaration on its website and in anticipation of marketplace changes, the firm diversified into solar and renewable energies. That strategy has paid off during the economic downturn.

The firm also provides complete design/finance/build/operate packages to clients, which are highly attractive to cash-starved municipalities. Psomas is now in a strong position to take advantage of the recovery, as it gets under way. “We are strategically planning to be in the best position possible when the economy turns the corner,” said Jacob Lipa, the firm’s president. “As our country begins to emerge from this recession, new initiatives like our entry into the energy market will ensure Psomas is well-positioned for strong growth in the years to come.”⁵

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responsible board is doing its job. SERA Architects, Inc. of Portland, Ore., is achieving success by combining urban revitalization with sustainable design. The combination proves highly attractive to urban centers in need of infill, reuse and redevelopment. The firm has created a white space that distinguishes it from competitors. SERA's sensitivity to historical preservation and context, and its application of the belief that green design means much more than just a certification, help attract clients who care deeply about these concerns.

Altoon + Porter recognizes that while architecture has universal

principles that apply to every project, every community has a specificity, local culture and unique psychology. The firm is known for projects that adapt and enhance urban streetscapes, and the firm's design professionals know that any work they do must be flexible to accommodate future changes as a building's use changes over time. By placing the commitment to local context, culture and community at the center of the firm's philosophy — and embodying this commitment in the practice and its project — A+P has become highly successful in the international marketplace and is widely renowned for the humanist appeal of its mixed-use and retail projects. [See Sidebar]

COMING UP IN THIS SERIES

Going forward in this series of articles, I will outline what boards can and should do right, explore best practices of highly successful boards and discuss how the boards of architecture and engineering firms can achieve such success. ■

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¹ Zofnass, Paul. "EFCG Engineering/Consulting Industry Overview for FIDIC." FIDIC 2009 Presentations. FIDIC, 15 Sept. 2009. <<http://217.197.210.21/conference/2009/talks/day3/plenary3/zofnass.pdf>>.

² Gillespie, John. "M.I.A. Boards – June 2010 – Alumni Bulletin – Harvard Business School." Alumni – Harvard Business School. <<http://www.alumni.hbs.edu/bulletin/2010/june/boards.html>>.

³ "Dina Merrill." Wikipedia, the Free Encyclopedia. Web. 17 Dec. 2010. <http://en.wikipedia.org/wiki/Dina_Merrill>.

⁴ Gayer, AIA, Diane Elliott. "Architectural Record | Letters to the Editor." Architecture Design for Architects | Architectural Record. Architectural Record, 1 Dec. 2010. <<http://archrecord.construction.com/community/letters/>>.

⁵ "Psomas Diversification Pays Off with Large Solar Projects." PSOMAS ENGINEERING – Balancing the Natural and Built Environment. 20 Oct. 2010. <[http://www.psomas.com/about/News/01Press Releases \(2010\)/78Psomas Diversification Pays Off with Large Solar Projects -October 2010.html](http://www.psomas.com/about/News/01Press Releases (2010)/78Psomas Diversification Pays Off with Large Solar Projects -October 2010.html)>.

HOW ALTOON + PORTER EXPRESSES CORE VALUES IN ALL OF ITS WORK

Ron Altoon, one of the founders and a partner of Altoon + Porter, explains how the firm established and maintains commitment to embodying the partners' core values in all of the firm's work:

"The culture of the firm, our core values which affect everything we do, comes out of a covenant that all partners embraced from the outset. Three partners formed Altoon + Porter in 1984, one with a background in management, one in tectonics and one in design. Noting that Vitruvius, writing in the Ten Books on Architecture in the first century, spoke of three essential aspects of architecture — firmness, commodity and delight — we adapted (perhaps paraphrased) these irreducible elements as we structured our practice and the interdependency between us. Each partner would have "last word" authority over one of these aspects applied throughout the practice, no matter who the partner in charge of a specific project may be.

Firmness became the business aspects of our practice: firm corporate (and later partnership) structure, contracts, legal, accounting, leasehold, tax, human resources and banking as well as all project management responsibilities such as scheduling, manpower, workload, profitability, etc.

Commodity became the technical aspects of all projects: engineering consultants, code research, fire/life safety compliance, construction documents and construction administration.

Delight became all aspects of design: master planning, urban design, architectural design, interior architecture and design consultants; outreach, such as marketing, business development, public relations; and education, profession, industry and community engagement.

We fashioned a matrix-management system, whereby the client was at the top, and on one side of the angled matrix was a partner-in-charge of a particular project with responsibilities to assure fulfillment of the client's mandate. The other side of the matrix had partners-in-charge of these three designated aspects of the practice, responsible to the partnership. They intersect on every project, making each of the partners accountable for his aspect of another partner's project. It works because the partners of both sides of the matrix are the same people. In my case, someone else is responsible to ensure that one of my projects has proper contracts in force, tax laws are being observed, etc., and that the project is properly staffed and budgeted. He holds our feet to the financial fire. Another partner assures that all applicable codes are respected during the design process, that the documents reflect the design intent, etc. If it violates good practice, he trumps the design to assure quality and compliance. I keep the responsibility for the design and communications aspects of the project. If the project were another partner's, I would assume last word responsibility for the design of his project. My design, not his, would prevail, as I set the design approach of the practice.

In short, we formed the firm as one architect in three bodies, with remarkable perspective vision. As we have grown, we have maintained this practice model and culture. We have filled in additional partners between the original three, dividing responsibilities such as practice management from project management, and technical documents from construction administration. However, the biochemical approach prevails.

Does it work? Since 1984, we have constructed projects valued at \$11B (in yesterday's dollars), with no legal judgments against us. We have worked in 42 foreign countries, with a relatively small staff. We are not smarter than anyone else, no more experience. But, this culture of collaboration, ceding to others what is defined within their domain, has served us well. Ego absent, so to speak."