Board Governance: The Effect on Business-Development Strategies

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It is no secret that banks and other financial service providers view small businesses as an important market for credit-related products and services. Owners of businesses with less than $10 million in revenue are bombarded by solicitations from financial institutions that want their business. To compete effectively, financial institutions need as many leverage points and strategies as possible.

The financial institution's board of directors can be a valuable asset in business development and relationship management within this market segment. Depending on the governance philosophy, the board can influence the business-development strategy and customer-relationship culture on numerous levels. In effect, boards with specific characteristics can add considerable value to the bank's efforts in this area.

In this article, we outline the features of a "value-creating" board to illustrate how a board and individual directors can promote the bank's business-development and customer-service strategy. We cite results from a recent survey by RSM McGladrey, which in part addresses this topic.

Vertical Integration

A first step in understanding the board's potential effect on business-development and customer-service strategies is to understand the roles of different players in the organizational hierarchy. At the top of the ladder is the board's involvement in establishing the mission, vision, and strategy of the bank. Such a framework provides the foundation for the acquisition, retention, and service strategies relative to the bank's business credit customers. Management, in turn, establishes the tactical approaches to support these strategies. Lending officers, credit analysts, and other staff implement these strategies.

It is clear from our survey of governance practices among community banks, that many community banks currently either do not have strategic plans or, if they exist, do not involve their boards in the process. Specifically, only two-thirds of community bank boards indicate that they have a defined role and process in developing the strategic plan. More than 20 percent of boards report they play no role in monitoring performance of the plan.

The strategic plan is the conduit to defining the business development roles of the board and management. The plan promotes alignment between the board and management, which can significantly advance the go-to-market effort. For example, a board that supports a strong business-development orientation may require management to report routinely on the development and success of various marketing and customer-retention strategies. This board policy makes it clear to management that business development will be measured and evaluated regularly.

The measurement and evaluation process itself needs enhancement in many banks. For example, our survey data indicate that approximately half of community bank

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boards do not provide at least annual performance feedback to the CEO.

Value-Creating Boards

Bank boards have many potential roles and accountabilities that are more fundamental to the board's charter than the support of business-development strategies. These include protection of shareholder interests, compliance with various regulations, and basic oversight of the bank. In addition, some boards are able to create value in ways that move beyond fiduciary responsibilities and help establish a strong business-development culture.

What are the features of board governance that have the most potential to add value to the business-development and customer-retention strategy? We have identified three governance approaches typically adopted by bank boards. The value-creating approach, with an emphasis on retaining directors with critical competencies, has the most potential to reinforce a strong marketing and business-development approach:

1. *Oversight boards.* These boards focus on compliance, risk management, and fiduciary responsibilities. They emphasize the development of checks and balances to monitor the compliance posture of the bank and minimize overall risk.
2. *Active governance boards.* In addition to the oversight qualities described previously, these boards establish strategies and corresponding goals and metrics to monitor the bank's performance. Oversight is still important, but more time is dedicated to business rather than compliance-related issues.
3. *Value-creating boards.* In addition to the active governance features, these boards maintain a clear strategic focus, use independent directors, provide competency-based advice, and establish a climate that supports a strong market/customer orientation.

Value-Creating Boards and Business Development

Features and practices of the value-creating board philosophy are evident in a number of board practices, roles, and activities. Our 2003 Survey of Community Bank Governance Practices, completed in conjunction with the Independent Community Bankers of America (ICBA), provides insight relative to the prevalence of these practices.

Director Reputation, Capabilities, and Networks

Traditionally, banks have asked business customers, market leaders, referral sources, and local business leaders to serve on the board. Directors with these qualities were valued for their linkage to important customer segments. While helpful in building relationships with individual customers, these directors often did not represent the entire customer base or provide important insight regarding trends and competitive practices across all market segments.

This is not to minimize the contribution that directors who are referral sources or have other links to the business community can make to the bank. However, it suggests that the competency profile of all directors as a group should reflect a broader set of business-development capabilities.

Value-creating boards develop a profile of desired director competencies that are beneficial to the governance of the financial institution. Often, a subset of the director competencies will encompass a market and customer focus. As director positions become vacant, new directors are recruited who best fit the overall competency profile.

Unfortunately, our survey results indicated that only about half of boards have a defined role and process for sourcing new directors. Fewer still, only 19 percent of community banks use a competency skill profile to select new directors. On a more positive note, our survey indicates that many bank boards have identified a number of market-related competencies important for future directors, including the following:

- Small-business owner or entrepreneurial experience
- Local business market knowledge
- Experience in the industries served by the bank
- Significant visible business community leadership

Financial institutions with a strong business-development and customer-service strategy and culture often retain one or more directors who have proven expertise in marketing, business development, customer service, and experience with specific customer segments. These banks also place priority on seeking directors who can open up new customer networks to the bank.

Director Independence

Value-creating boards are typically composed of board members who can be considered independent and, therefore, are aligned with shareholder interests in an objective and unbiased way. Based on our survey results, the median number of directors on a community bank board is eight, which provides an opportunity to retain five or more independent directors.

A number of regulatory organizations, such as the Securities and Exchange Commission (SEC), define what it means to be an independent director. All definitions share a common framework that makes it impossible for insiders, such as bank employees and managers, to be considered independent.

Independent directors can be a valuable resource for assessing the bank's go-to-market strategies. One benefit of an independent director is his or her ability to review and suggest market and business-development approaches from an objective point of view. For example, if owners of businesses served by the bank are also directors of the bank, it may be difficult for them to promote the review and development of new market segments.

Customer and Business-Development Culture

Value-creating boards can promote a customer and business-development culture through a number of board roles and actions.

First, board meeting agendas and information packets can require bank management to track economic conditions, customer-related trends, new products and services, and so forth. Our survey data indicate that relatively few board information packets address these issues (*e.g.,* only 47 percent of packets include updates on new products and services). The information packets of value-creating boards frequently include results of customer surveys, market share analyses, and competitor information. What is measured is often emphasized and actively worked on by the management team.

Second, a business-development-strategy committee can be formed at the board level. This committee would focus on tapping into its network for referrals and increase its presence in the business community on behalf of the bank. Also, it can more fully develop the bank's marketing, product development, customer retention, and cross-selling strategy by focusing attention on these issues.

The committee should consist of directors who are in a position to provide industry, market, or customer-oriented advice. Often, creating this committee is most beneficial when the bank is considering penetrating new markets or serving customer segments that are different than the traditional customer base.

Our survey results indicate that this is not one of the four standing committees typically established by the board. The loan committee, however, often conducts many of these activities informally.

Third, the board can shape each director's expectation that she or he should be involved in some aspect of business development. Value-creating boards define the expectations for directors in a formal document, which includes specific activities related to business development. Our survey results indicate that only 20 percent of bank boards have a written description of the director's role.

Our survey indicates, however, that a large percentage of banks expect individual directors to support loan and business growth through participation in business-development activities, cultivation of referrals, and providing the commercial lending staff and other bank executives with access to their business networks.

Formal Board Accountabilities

Board roles and accountabilities define the orientation and expected actions of the board. In effect, they define the work of the board. The value-creating board embeds a business-development and customer-service orientation in numerous aspects of its operating philosophy as expressed in the following board guidelines:

- *Board charter* refers to the importance of maintaining the bank's financial performance by serving specific customer segments in the business community.
- *Strategic plan* presents and monitors metrics relative to business development and customer retention and service.
- *Executive compensation* is aligned with business-development, customer-service, and customer-retention goals.
- *Board agendas* include a review of markets, customer segments, loan activity, distribution channels, and credit-customer-retention trends.

Competency-Based Advice

One distinguishing feature of value-creating boards is the attraction and retention of individual directors who can advise the executive team on strategic business development. Three director competencies are particularly important in this regard. First, directors with specific industry expertise can assist in defining unique customer needs and attractive product and service strategies.

Second, experience and knowledge of business-development programs, such as marketing research, marketing approaches, sales and channel distribution strategies, and customer relationship management (CRM) technologies, can accelerate the effective implementation of business-development programs.

For example, one community bank was struggling to identify which of its high-net-worth retail customers were also business owners who could use the bank's commercial credit products. A board member who worked in a much larger company introduced a CRM approach to track the services used by the high-net-worth retail customers. Based on various cross-references of retail and commercial customers, a new product and service configuration (*e.g.*, business checking linked to merchant credit card) was developed to integrate discrete retail and commercial credit services and products. These products and services were used to attract new customers within the business banking segment.

Third, director contacts with business leaders in different market segments served by the financial institution can be a valuable resource for the commercial lending or business-development functions. Typically, directors are not recruited purely for their access to networks; however, directors who have other critical competencies along with access to business networks can be a definite plus for the bank.

Loan Committee Composition, Charter, and Process

Director participation on the loan committee can establish a formal tone and formal structure that influences the business-development strategy of the financial institution. Our board governance survey found that 89 percent of community banks maintain a loan committee that meets, on average, 15 times per year. Almost all banks (96 percent) have management representation on the committee, in addition to directors.

Broad representation and frequent meetings provide an ongoing opportunity to monitor and support business-development activity. Loan volume, complexity of the credits, and changes in customer needs provide a built-in monitoring process to alert the board of the bank's business-development strategy and customer trends. In addition, discussion of credits by the lending officer or management highlights the customer networks that individual directors may be able to access on behalf of the bank.

Governance Diagnostic

A board diagnostic and evaluation is an excellent starting point for the board to adopt a value-creating governance philosophy that emphasizes business-development and customer-service strategies. Board governance diagnostics are relatively rare among community bank boards, but are becoming more prevalent due to new regulatory requirements. Only 26 percent of community banks reported that they conduct a formal annual review of the board's effectiveness.

The diagnostic process can be an important way to unleash the board's potential in support of the bank's marketing and business-development approach. The diagnostic themes will differ from organization to organization. A basic diagnostic would include the following questions:

- Does the board review and approve a business-development and customer-service strategy as part of the overall strategic plan?
- Does the board meeting information packet include performance on business-development and customer-service metrics?
- Do director role descriptions create an expectation to assist the bank in accessing professional networks and business leaders in various markets for business-development purposes?
- Can directors articulate the business model in sufficient detail to represent the bank in professional forums?
- Are results of the loan committee reviews reported to the full board in terms of customer requirements and trends?
- Has the board approved an executive/management compensation strategy that reinforces business development and customer service—backed up by an effective performance-appraisal process?
- Is experience and knowledge of specific industry segments, customer segments, and marketing strategies a part of the competency profile for the board?
- To what degree are directors informed of broad trends in the marketplace?

- Are independent directors provided an opportunity to meet without management and offer advice on business-development and customer-service issues?
- Are business-development and marketing criteria present in the CEO's performance appraisal?
- Is there ongoing board education dedicated to learning about current and prospective customer segments?

Typically, these questions and others are answered by each of the directors and summarized in an overall profile of the board's effect on business-development and customer issues. Affirmative answers to these questions would position the board to add value by supporting and reinforcing a culture of customer-service excellence and business development. A negative response to any of these questions would require the board to develop a plan for improvement.

Director and Management Responsibilities

It is critical that the board remain on a strategic and monitoring level relative to executing business-development strategies. The board can set the tone and support a climate of business development and marketing; however, it cannot replace or supplement management's responsibility to develop credit products and related services and to interface with customers.

When policy development, which is a board role, becomes confused with execution, which is management's role, business-development strategies become diffused and confused. A value-creating board stays at the strategic level. Through adoption of various governance principles and operating policies, the board can add value to the bank's business-development strategies, as well as fulfill its oversight and active governance roles.