

Distinguishing Governance FROM Management

By Barry S. Bader

“What is the difference between governance and management?” is by far the question that not-for-profit executives and directors ask most often. Effective boards understand the difference between governing and managing; dysfunctional boards do not.

The traditional, easy answer—that the board makes policy and management carries it out—is too simplistic. It offers little practical guidance at a time when fiduciary expectations are rising. Nowadays directors serve on boards to make a difference, not just to be names on the letterhead and donors on a wall. Today’s boards *must be* informed and *want to be* engaged, both to fulfill their legal obligations and to leverage their time and talent to advise management. But — at what point does appropriate engagement cross the line into running the show?

It is tempting for directors to believe they are doing their jobs by delving into management decisions. The temptation is particularly strong for some, such as physicians who practice

Seven Guiding Questions

- Is it big?
- Is it about the future?
- Is it core to the mission?
- Is a high-level policy decision needed to resolve a situation?
- Is a red flag flying?
- Is a watchdog watching?
- Does the CEO want and need the board’s support?

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at the hospital and think they know how things should be done. It’s tempting for outside directors who may bring ideas based on what works in *their* businesses or what

they’ve heard from friends who are physicians or nurses.

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Wise directors avoid the temptation to co-manage or second guess. Directors’ fresh thinking and applied business knowledge are desirable, but health systems and hospitals are complex organizations with multiple moving parts. Tinkering in one area will affect many others. Complex organizations require strong, knowledgeable executive leadership to get everyone pulling in the same direction. They require tough choices about people and about what can and cannot be funded. Boards that try to manage often end up generating unintended consequences. They undermine the CEO’s credibility and authority, to the detriment of the organization as a whole. They also risk driving away competent executives and directors who don’t agree with a hands-on approach to governing.

Governance Roles and Responsibilities

An understanding of the difference between governance and management rests on the cornerstone of fiduciary responsibility. Just as corporate boards are accountable to shareholders, the governing body of a not-for-profit organization has a fiduciary responsibility to see that the organization is acting in the best interests of the public, and more specifically the “stakeholders” who are served by the organization’s mission. For the not-for-profit hospital, the highest-order stakeholders are the patients and the community.

Figure 1: The Board-Management Relationship

Board’s Roles	Management’s Roles
Select, evaluate, and support the CEO.	<ul style="list-style-type: none"> — Run the organization in line with board direction. — Keep the board educated and informed. — Seek the board’s counsel.
Approve high-level organizational goals and policies.	<ul style="list-style-type: none"> — Recommend goals and policies, supported by background information.
Make major decisions.	<ul style="list-style-type: none"> — Frame decisions in the context of the mission and strategic vision, and bring the board well-documented recommendations.
Oversee management and organizational performance.	<ul style="list-style-type: none"> — Bring the board timely information in concise, contextual, or comparative formats. — Communicate with candor and transparency. — Be responsive to requests for additional information.
Act as external advocates and diplomats in public policy, fundraising, and stakeholder/ community relations.	<ul style="list-style-type: none"> — Keep the board informed, bring recommendations, and mobilize directors to leverage their external connections to support the organization.

Today’s boards carry out five primary roles as independent fiduciaries (see Figure 1): choosing the CEO, approving major policies, making major decisions, overseeing performance, and serving as external advocates. Hospital and health system boards focus their attention on the organization’s mission and strategic direction, finances and investments, quality, community benefit, and corporate compliance with laws and regulations. The role of management, led by the CEO,

is to operate the organization in line with the board’s direction. Management makes operational decisions and policies, keeps the board educated and informed, and brings to the board well-documented recommendations and information to support its policy-making, decision-making and oversight responsibilities.

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Seven Guiding Questions

Even when the mutual roles of the board and management are understood, there isn't always a bright line distinguishing governance from management. Different situations will affect the appropriate level of governance involvement. Adverse results may call for closer board oversight. For example, if the organization is in a financial downturn, is not improving subpar quality scores, faces allegations of improprieties, or is considering a merger or major transaction, the board may become more engaged and review more detailed information than it normally would. Otherwise, a governing board functions best when it focuses on higher level, future-oriented matters of strategy and policy and performs its oversight responsibilities in a rigorous but highly efficient manner.

Seven questions can help a board and management to agree on their appropriate roles for any matter of board oversight or decision making:

1. Is it big? The bigger the impact of a decision, the more the board ought to play a role in shaping and understanding the action and its possible consequences. One rule of thumb is that organizational decisions impacting roughly 10 percent or more of an organization's revenues or activities are strategic decisions. A decision on whether to start or greatly expand major clinical service lines such as cardiology, oncology, and orthopedics would be a strategic matter. Planning

how to implement the expansion is management's responsibility. The corollary to "Is it big?" is "Is it too small to merit the board's attention?"

2. Is it about the future? Boards make their impact on what the organization will look like five or more years down the road. The board's fingerprints should be on the organization's long-term vision and an integrated, three-to-five-year strategic and financial plan, as well as a master facility plan. Tomorrow's campus is the work product of today's board and management. Boards should rely on management to develop draft strategy documents for board input and approval. A board-approved strategic plan should have several major focus areas, such as quality, growth, finances, and people, with measurable goals for key indicators and initiatives in each area. Another rule of thumb: if the board-approved strategic plan has more than five or six strategic areas and more than about 20 strategic initiatives under those areas, the plan is probably management's operating plan and the board is getting involved at too low a level.

3. Is it core to the mission? As a fiduciary, the board is the guardian of the mission. Questions such as whether to continue a financially underperforming facility, how much to invest in community benefit activities and whether to open clinics in medically underserved communities call for the board to examine strategic and financial decisions in a mission context. Management should bring the board well-documented analyses and recommendations to help directors strike

the right balance when mission and financial realities come in conflict.

4. Is a high-level policy decision needed to resolve a situation?

A policy sets forth principles, guidelines, or practices to be applied in certain situations. For example, should a physician member of the board who invests in a competing facility be permitted to continue in office and practice on the medical staff? Should a manager be permitted to dismiss an employee who he says is underperforming, but who has filed a complaint alleging the hospital is violating Medicare payment rules? These situations call for consistent decision-making based on policies on physician competition and whistleblowers, respectively. Other common hospital board policies address such matters as conflict of interest, charity care and community benefit, executive compensation, CEO evaluation, and public transparency. A board's policies should be compiled into a policy manual that is available for reference at any board or committee meeting and distributed to every trustee. Of course, organizations have hundreds of operational policies governing various aspects of personnel, finance and billing, and patient care. These are not board matters. Policies requiring board approval should have a major impact on the organization, require compliance with laws or regulations, or affect the responsibilities and conduct of the board, management, and subsidiary boards.

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5. Is a red flag flying? Boards should routinely review dashboards and other performance reports, but when should they get into more detail discussing results and raising questions? Directors should know the red flags that signal the need for closer inquiry. Boards and especially oversight committees should focus on trends. One rule of thumb states that statistically significant over- or underperformance on a strategic, quality, or financial indicator over at least three reporting periods constitutes a trend. Of course, sentinel events, reports of unethical or illegal activity, or dramatic underperformance require prompt board or committee review before a trend develops. Red flags may also appear in reports from the external auditor, general counsel, accreditation agencies, and others. To avoid slipping from governance into management when reviewing performance problems, the board should focus on whether management recognizes the problem and has established the capability and plans needed to improve results. The board should not micromanage possible solutions; it should hold management accountable for producing better results.

6. Is a watchdog watching? If Congress, IRS, the state attorney general, or the news media care, the board should care. Hot button issues of the moment include community benefit, charity care, executive compensation, medical errors, and publicly available quality results. Boards should be proactive on high-profile issues, adopting

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appropriate policies, overseeing performance, and ensuring the organization has a proactive public communications strategy.

7. Does the CEO want and need

the board's support? If the CEO asks for board advice or intervention, directors should respond. When CEOs are about to embark on career-limiting activities, such as fighting a labor union or terminating the contract of a noncooperative but popular physician group, the executive must know the board will stand firm. Sometimes CEOs want the board to challenge management to raise the bar for performance, which gives the CEO the board's backing to ask more from senior leadership and the medical staff. CEOs may also ask for help from directors with connections with donors, legislators, and community stakeholders. When the CEO calls, good boards respond.

Some practices and structures can help a board stay out of operations and focus on governance. The chairperson should exercise leadership and not hesitate to keep discussions focused on a higher plane. A CEO's letter to the board between meetings updates the board on recent events and obviates the need to discuss operations at meetings. A consent agenda enables a board to handle routine matters without discussion and frees up time for more important matters of policy and strategy, as well as board education. Committees for finance and investments, quality, audit and corporate compliance, and executive compensation have clear governance purposes. Conversely, in many cases, board committees on marketing, personnel/human resources, and facilities engage board members in management work and usually aren't needed.

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Most importantly, the board should elect members who understand and respect the difference between governance and management. Choose wisely, seeking as directors individuals who bring no personal agendas, understand the role of management in large, complex organizations, and have a desire to work as part of the board-management team. Then conflicts between the board and management will be rare.

— *Barry S. Bader*