CEO J.T. Battenberg III was determined his directors be not just independent, but engaged.

DELPHI BUILDS A BOARD

by Andrea Gabor

Illustration by Tavis Coburn

It was a cold Wednesday in January 2003. J.T. Battenberg III, CEO of the Delphi Corporation, the world's largest automotive supply company, leaned back in his chair and dwelled not on the success of his largest customer, the General Motors Corporation, but on what he had learned from its past failures. He was describing the wrenching years a decade earlier when GM wrestled with the ouster of its CEO and a major corporate governance crisis.

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In 1992, the General Motors board forced out CEO Robert C. Stempel, a GM lifer, after he had served just short of three years in the top job. At the time, Mr. Battenberg was an executive vice president at GM. He watched as the company's market share eroded, and Mr. Stempel took the fall. During this time, Mr. Battenberg also witnessed GM's quiet revolution, in which the largely nonmanagement GM board selected a new CEO, John "Jack" F. Smith, Jr., and a nonexecutive lead director, John G. Smale, the former CEO of Procter & Gamble Company. Mr. Smale helped put in place guidelines designed to ensure the active monitoring of management by independent directors. "I was exposed for about seven years to Smale's leadership style and that of his corporate governance guru, Ira Millstein," recalls Mr. Battenberg, who had sat in on board meetings. "It became clear to me the value of the separation between the corporate chairman and the lead director."

To an outsider, Mr. Battenberg's interest in relatively ancient GM history and in corporate governance, might seem misplaced, given Delphi's immediate challenges. A former division of General Motors spun off in 1999, Delphi still gets about 65 percent of its business from GM (a proportion that has steadily shrunk since the spin-off). But Delphi has faced some trying times for the past three years as it feels its way as an independent company and deals with the turmoil and weakness in the global automotive industry. A sharp drop-off in GM sales reduced Delphi revenues in 2001 to $26 billion, about a 10 percent decline from the previous year. In 2002, sales and earnings recovered somewhat; sales reached $27 billion, and net income grew from a $370 million loss in 2001 to a positive $343 million.

In the face of near-term financial pressures and troubles in the automotive industry overall, is corporate governance really worth the CEO's precious time and attention? For Mr. Battenberg, who began his career as a GM Institute student in 1961 and spent close to four decades at General Motors, including some of the rockiest years in U.S. automotive history, the answer is emphatically "yes."

Indeed, ever since he became the head of Delphi, which has nearly 192,000 employees (about half as many as its former parent), Mr. Battenberg has been determined to forge a new management and governance culture — one that breaks the ossified mold that led GM and the other two of Detroit's Big Three automakers through so many upheavals during the last 20 years.

With the help of the late Thomas H. Wyman, a former chief executive of CBS who left the GM board to become Delphi's first lead director, Mr. Battenberg set out to build what Jay Lorsch, a corporate governance expert at the Harvard Business School, calls one of the most effective and unusual boards in the country.

What sets Delphi's board apart, in large measure, is a design that positions it to be completely engaged in strategy, not just to serve as an independent advisory council. Individual directors have been selected to support Delphi's specific managerial and strategic challenges:

- Diversifying Delphi's core automotive business beyond GM, especially into foreign markets;
- Developing new nonautomotive markets, such as electronics and even consumer electronics;
- Cultivating a strong bench of line executives who will have the breadth and depth of experience to lead Delphi in the future.

"If you get the right board and give them enough time to talk and think and act strategically, they'll make important contributions," says Mr. Battenberg. That's very different from the way management traditionally has treated boards, he adds: "cramming them into a dark room, showing them some slides, and then saying, 'Thank you very much for coming.'"

Engaging a Board

For years, Delphi was responsible for supplying the world's largest automaker with everything from electrical systems to airbags. In 1992, GM began to reconsider the need to maintain an in-house parts supplier. Mr. Battenberg was asked to lead and chart the long-term strategy for GM's large and diffuse supplier operation (made up of 13 highly autonomous divisions), known as the Automotive Components Group Worldwide (ACGW). In 1995, the ACGW changed its name to the Delphi Automotive Systems Corporation (which was later changed to the Delphi Corporation). In the ensuing years, Mr. Battenberg consolidated several operations into seven divisions, all with decentralized profit-and-loss responsibility, and developed a common marketing strategy and organizational objectives. Eventually, GM decided that spinning off Delphi would benefit both organizations by giving the newly independent company the chance to develop non-GM customers, and by allowing GM to broaden its supplier base. For Mr. Battenberg, the spin-off also provided a singular opportunity to run his own company.

Mr. Battenberg's experience at GM had certainly made him highly aware of the importance of a strong, independent board of directors, long before the current outcry for governance reform was in daily headlines or business leaders were admitting it was time for a change. While Mr. Battenberg had — and still has — a healthy appreciation for the discipline that an independent board imposes on Delphi's management, he is equally driven by a conviction that the board should serve as a resource to him and to his lieutenants in developing strategy, fostering new customers and markets, and even solving technological problems — despite the potential for conflict with senior management. One of the best things about a hands-on board is also one of the hardest things, says Mr. Battenberg: "The brutal frank openness that forces us to deal with reality."

At the time of the spin-off, Mr. Battenberg and Mr. Wyman agreed to select board members based on skills they thought would be useful to the company, including sales and marketing experience in the U.S. and abroad, experience handling union relations, and technological know-how. They hired the global executive search firm Egon Zehnder International to generate a list of candidates based on the criteria. Among the first directors retained were Roger S. Penske, founder of the Penske Corporation, an auto and truck leasing and service company, and John D. Opie, a former vice chairman of General Electric Company. Mr. Opie is currently lead director, having taken over when Mr. Wyman retired.

Mr. Battenberg's board is a textbook study of the board as resource. The 12 directors — nine of whom are outsiders — have a rich body of industry-specific knowledge to support the company's key strategies. Mr. Penske, for example, is considered one of the most knowledgeable "car guys" in Detroit. Another three international automotive experts give Delphi entrée to the trio of major markets the company is targeting for new business — Japan, Latin America, and Europe. Shoichiro Irimajiri, the former head of Honda of America Manufacturing, is one of the highest-ranking Japanese executives to sit on a U.S. board, and lives in Tokyo, where he helps open doors for Delphi. Bernd Gottschalk is president of the Association of the German Automobile Industry and a former executive with Mercedes-Benz. Oscar De Paula Bernardes Neto, a Brazilian, formerly was an automotive consultant in Latin America, the CEO of Bunge International, and a senior vice president with Booz Allen Hamilton.

Several board members, including Patricia Sueltz, an executive vice president with Sun Microsystems Inc., have experience in the electronics or telecommunications industries, both of which are targets as Delphi seeks to expand its product lines into nonautomotive business. And Mr. Opie offers first-hand knowledge of the management practices at General Electric, the company that Mr. Battenberg considers a model for leadership development and succession planning.

Outside the Glass Tower

Delphi's governance structure is designed both to give its directors maximum exposure to employees and the workings of the company, and to utilize their skills as effectively as possible. Board involvement in the company is embedded in a series of formal and informal communications channels. Delphi convenes seven board meetings each year; data collected by the executive search firm Spencer Stuart on the frequency of board meetings suggests this is about the norm for large U.S. companies. Board members also participate in an annual three-and-a-half-day strategy retreat together with 30 line executives.

The board's involvement in strategy making is, governance experts say, highly unusual. "This is one of the most interesting and unique things about the board of Delphi," says Jay Lorsch, a Harvard Business School professor who has written a case study on Delphi with his Harvard colleague Rakesh Khurana. "Most boards have a great deal of difficulty getting constructively engaged in the dialogue about strategy — by that I mean the goals a company is going to pursue and how it will pursue those goals. The board at Delphi is engaged in a constant dialogue."

The dialogue begins at the three-and-a-half-day strategy meeting. "They continue to talk about the strategic issues at all the board meetings, so that sets up an agenda of issues," explains Professor Lorsch. "The retreat is just the starting point of an ongoing dialogue. It's a continuous process." It continues throughout the year as board members are in various degrees of communication with Delphi's executive leaders and managers.

That iterative communications process takes board members across the full range of issues the company faces, including finding new markets, identifying future leaders, and ferreting out — and solving — key technological challenges. During the retreat, "we spend the time reviewing the business, looking at the operations and the market, and setting the strategy for the next year," says Mr. Opie, who says he's in touch with someone at Delphi almost every day. "At board meetings, we have updates on specific parts of the strategy. So the board is involved in the development of strategy and stays close to its execution."

Board members have many opportunities to get to

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know a wide variety of Delphi personnel. "We have reviews and committee meetings and dinners," says Ms. Sueltz, who has served on the Delphi board for three years. "Even the dinners aren't just for us to glad-hand each other; they're set up with the thought of bringing in folks who aren't necessarily only the top executives so we can interact with them. Then, we'll hear them pitch in operational or strategic reviews. That causes lots of interactions to blossom."

Unlike most board members, who are confined to the glass-and-chrome tower of the head office, Delphi's board members are accessible outside the retreats and special events. In fact, the company strongly encourages employees and board members to seek one another out via informal channels and in the course of regular business. That's how Nancy Glenn, a systems architect who works on semiconductor technology for Delphi's Delco Electronics division in Kokomo, Ind., came together with Ms. Sueltz just one month after she had joined the board in 2000.

The two women met at a Java software conference in San Francisco in June of that year. At the time, Ms. Glenn was trying to apply Java software to the development of a system for error-proofing semiconductor fabrication, and was looking for "outside validation" of the system architecture and the technology choices that her team was using. Ms. Glenn and her colleagues were bemoaning the fact that finding software engineers who use Java for manufacturing applications — as opposed to Internet or entertainment applications — was like searching for a needle in a haystack.

Nancy Glenn found her needle while listening to Ms. Sueltz, who is responsible for all Java technology at Sun, give the keynote address at the San Francisco conference. During her address, Ms. Sueltz happened to mention the hotel where she was staying in the city. After the speech, Ms. Glenn went there unannounced, telephoned Ms. Sueltz's room, and asked for an appointment. "Pat didn't know who I was, only that I worked for Delphi," recalls Ms. Glenn. "She was very useful in putting us in touch with some Sun Java architects who were working with the auto industry in Dearborn."

A few weeks after the conference, Ms. Glenn and her colleagues drove from Kokomo to Dearborn for two half-day brainstorming sessions with a roomful of Sun architects. The sessions were followed by a series of e-mail interactions. "This speaks of the Delphi culture — the openness that J.T. encourages and the idea that the board is a resource," says Ms. Sueltz. "When J.T. was recruiting me, he said, 'We want our folks to be able to approach you.' What they are pushing for us to do is not only be independent board members but active and involved board members." Indeed, Ms. Sueltz has played an advisory role to a number of businesses inside Delphi that are trying to expand their nonautomotive business. For example, she has given advice on expanding Delphi's XM SKYFi satellite radio products into consumer markets.

Similarly, following a board presentation last December by Ray Johnson, Delphi's executive in charge of compressors and new markets, Ms. Sueltz helped connect Mr. Johnson's team with Sun experts in thermal technology. Delphi wants to use its expertise in climate control and powertrain cooling systems to develop products for the electronics industry. One potentially lucrative market: systems that cool hot spots inside cabinets that contain such electronic equipment as computer servers. Sun experts helped Mr. Johnson's team understand the technical requirements for these so-called enclosure blowers. Ms. Sueltz insists that she recuses herself from any decisions involving sales to or from Sun. However, Delphi hopes this technological dialogue with Sun's electronics experts might one day turn into sales.

Inside the Operations

Perhaps no board member exemplifies the hands-on nature of Delphi's board — and Mr. Battenberg's desire to bring the expertise of directors to bear on the company's most critical strategies — more than Mr. Irimajiri. Mr. Battenberg spent much of his career as an auto engineer fighting against the flood of innovative Japanese imports, and trying to learn the stubbornly elusive secrets of such Japanese innovations as lean engineering, the concept the Japanese apply to everything from manufacturing to product development, to improve efficiency and design without adding costs.

Two years ago, Mr. Battenberg gave Mr. Irimajiri what was, for a company director, an atypical assignment: to conduct a yearlong, in-depth study of Delphi's manufacturing, engineering, and product development processes. (As required by the Securities and Exchange Commission, the consulting agreement, under which Mr. Irimajiri was paid about $800,000, was disclosed in the company's proxy statement.) Mr. Irimajiri's task was to help Delphi identify and make improvements on the weaknesses that stood in the way of achieving what Mr. Irimajiri calls Operation Mt. Fuji. (What was the Japanese code name for Pearl Harbor is, at Delphi, the moniker for the company's campaign to grab a larger share of the Japanese auto parts industry.)

Much of Mr. Irimajiri's focus was on bringing to Delphi lean-engineering concepts implemented by such companies as Toyota and Honda, which many U.S. companies have tried to learn, with little success. At the most basic level, lean-engineering concepts rely on broad communication across disciplines so that, for example, design engineers, manufacturing experts, and suppliers all communicate and cooperate in an effort to optimize design and slash costs. Delphi has successfully applied the concepts to such manufacturing challenges as just-in-time inventory controls and teamwork on the plant floor. But applying lean engineering to design and product development also involves a continual learning process; the knowledge that goes into perfecting everything from processes to parts must be codified and institutionalized in the company's managerial culture and engineering toolkit, so it can be used as a building block for future projects.

That institutional integration had eluded Delphi, even though the company has worked on the techniques for more than six years with James Womack, one of the leading U.S. experts on lean manufacturing. Mr. Irimajiri's study was invaluable in showing that what made lean engineering so difficult for U.S. companies has as much to do with philosophy as it does with engineering.

Mr. Irimajiri "kept suggesting to us that the Japanese culture is so deep that even with the best of intentions we might be better served by having someone who's done it, someone who's coming out of that culture," says Mr. Battenberg.

Today, the influence of Mr. Irimajiri's study is evident all over Delphi, apparent in the way the company approaches its supplier relationships and in key new hires, including consultants and employees, who are *sensei*, the Japanese term often used to denote a master in such areas as total quality management or lean engineering.

Significantly, Mr. Battenberg recognized that implementing Mr. Irimajiri's recommendations would not be as simple as "writing down the eight or 10 things we have to change" and then changing them. Some changes will require years of work. Take the application of lean concepts to Delphi's suppliers and to its own relationships with customers, one of the challenges identified in the Irimajiri study. To make "lean" work in these areas, Delphi needed to shed the supplier culture and practices it had inherited from GM. "The culture we came out of was so repulsive from the standpoint of purchasing," says Mr. Battenberg, referring to the regime of Jose Ignacio Lopez de Arriortua, GM's purchasing czar from 1992 to 1993. Mr. Lopez was known for fostering brutal price competition that often strained relations between automakers and their suppliers.

As Delphi follows through on its director's recommendations, the company knows it still has a long way to go to mend relations with its suppliers. But Mr. Irimajiri's connections at Honda turned out to be a good networking opportunity for Delphi. Just around the time that Delphi was mulling the results of Mr. Irimajiri's study, Donald L. Runkle, who is Delphi's vice chairman and chief technologist, met R. David Nelson, the former supplier chief for Honda, and recommended that Delphi hire Mr. Nelson. Mr. Irimajiri endorsed the decision, and Mr. Nelson became Delphi's purchasing chief in February 2000.

Mr. Battenberg is quick to point out that while Delphi values the knowledge of its directors, the company is run entirely by Delphi management, which is free to reject board suggestions. Some of Mr. Irimajiri's recommendations, for example, are not feasible in an American company subject to American market forces, he believes. The Japanese "really are not interested in quarterly earnings; they're interested in investing for the long term," Mr. Battenberg says. "We could not implement all his recommendations because of that very point. If we tried to convert overnight and go a few quarters without any profit…" His voice trails off as he muses the consequences of such a rash act.

Accordingly, Mr. Battenberg has been forced to modify a key Irimajiri recommendation that he thinks would otherwise make perfect sense: moving a significant number of Delphi engineers to Tokyo for the entire two- to four-year product development cycle of a new automobile, to improve the company's ability to work with and co-develop entire product systems with a Japanese automotive manufacturer. "We've done that, but we haven't done as much of it as we might like," says Mr. Battenberg, because it would involve transferring huge numbers of people from America to Japan, at great cost.

The challenge comes down to balancing Delphi's short-term need to maintain earnings with the long-term strategic necessity of expanding its overseas business. Japanese automakers, who are the benchmark for engineering excellence, now account for close to 10 percent of Delphi's sales; Delphi's share of Japanese business continues to creep up, albeit in low-single-digit increments each year, and is a major focus of Delphi's engineering efforts. The company's future success will depend on forging more "strategic supplier" relationships like the one it has with Toyota, in which Delphi supplies sound systems and electronic control modules that regulate such things as engines and catalytic converters. Delphi also hopes to pare its own supplier base and to forge similar long-term collaborative relationships with its own suppliers.

Deep Succession Planning

Tough competition in Japan and Europe, emerging markets such as Korea, and a desire to improve its engineering systems and technologies are also behind Delphi's highly structured management development process.

"We spend a lot of time on progression and succession planning," says Mr. Battenberg. Each year, the company identifies 40 to 45 candidates for officer positions, going three or four levels down in the organization. Those candidates are invited to meet with the board in a variety of settings — social events; meetings, where they are asked to give formal presentations; and the three-and-a-half-day strategy retreat.

Management experts note that the current corporate governance crisis grew, in part, out of a failure by many companies to develop a strong slate of internal candidates to succeed an existing CEO and to fill other crucial positions. "In most companies, succession plan-

The board knows who is immediately promotable. Having them look for leaders who are two or three years from promotion is even more valuable.

ning begins toward the end of a CEO's tenure," says Jay Conger, a professor of leadership at both the London Business School and the University of Southern California. "That's one thing that's wrong with the process. Companies also need to think about developing a strong bench." One obstacle to doing so, Professor Conger adds, is that "in American culture, executives expect that they're going to be moving constantly" and, during the 1990s, "the war for talent drove faster turnover." That is, companies felt they had to promote high-potential executives quickly, or risk losing them to competitors.

Delphi is consciously trying to stretch the tenure of key executives. "Irimajiri says that American companies rotate too fast," Mr. Battenberg says. "I would like to expand and lengthen the time" that key executives stay in their jobs. Adds Mr. Opie, Delphi's lead director: "We'd like them there long enough so they can live with their decisions." The Delphi board reviews the list of high-potential candidates periodically, adding candidates as some are promoted and others fall off the list.

Board members have also weighed in on moving senior executives to different locations, says Ms. Sueltz, to give them "a truly global perspective."

For Mr. Battenberg, having the board looking deep inside the organization for future talent is enormously valuable. "The board is very familiar with those people who are immediately promotable. We want to get them exposed to candidates who are two or three years away from promotion," he says.

To evaluate high-potential candidates, Mr. Battenberg has borrowed heavily from GE methods. For example, he has broadened the number of line executives who have profit and loss responsibility. The seven presidents of Delphi's divisions always had P&L responsibility, even when Delphi was still part of GM. But now he is pushing that bottom-line responsibility down the hierarchy to the next 30 line executives.

Measuring the Board

Delphi executives, and others who are close to the company, insist that the structure for charting strategy and for evaluating executives and board members keeps the freewheeling dialogue in check. Indeed, both board members and executives undergo a careful assessment each year. Board members serve three-year staggered terms. And only outside directors serve on the board's three standing committees: the audit committee, the compensation and executive development committee, and the corporate governance and public issues committee. (Although the New York Stock Exchange rules are requiring some board committees — the audit committee, for example — to be made up exclusively of outside directors, Delphi's committee structure predated and goes beyond the current guidelines.) During the annual retreat, concrete objectives for key performance measures, including market share and employee development as well as standard financial targets, are determined. Mr. Battenberg and his direct reports are evaluated on how they meet those goals.

The pursuit of better corporate governance has its downside as well. Last year, for the first time since the spin-off, Mr. Battenberg and his senior lieutenants did not receive a cash bonus. And although many people saw the benefits of Mr. Irimajiri's involvement, the company terminated his consulting agreement after just one year to avoid the appearance of a conflict of interest.

With the auto industry under continued pressure, management and the board now face the greatest business challenges since Delphi's spin-off three years ago. The stock price has declined from a high of just over $20 at the end of 2000 to about $7.50 as of early April 2003. Moreover, Delphi's preferred status as a GM supplier, which it enjoyed for three years under its spin-off agreement, expired in January; now Delphi will have to compete on cost and quality with other potential GM suppliers. Delphi also is still struggling to offset the benefits of its GM experience with the need to forge a new culture. Even Delphi's greatest fans note a certain "GM arrogance" that persists at the company. Delphi executives spend hours each day responding to internal e-mails. Some Delphi units have inherited a penchant for bureaucracy that rivals the company's erstwhile parent's. Bureaucracy, say experts close to the company, has also bogged down the process of taking innovations from the lab to the marketplace. Shedding that culture will be as important as a knowledgeable and activist board in giving Delphi the nimbleness it needs to move quickly into new markets.

In addition, during these rough economic times especially, striking the right balance between management prerogatives and an activist board might be tough. David Wohleen, president of Delphi's electrical, electronics, safety, and interior sector, noted in a Harvard Business School case study on Delphi: The "leadership team has [the] obligation to run the company. You don't want to get to the point where you've engaged everybody so much that you're now doing errands for the board and you're distracted from running the company."

Delphi says that it has achieved a healthy balance between board involvement and management's need to establish a vision and to chart its future. In fact, the current chaos of the financial markets and slow global economic growth might give boards such as Delphi's more leeway to set long-term objectives than they had during the boom years. Still, with the typical U.S. investor holding stocks for only 290 days in 2002, "the problem directors have is that they don't know who the shareholders are," says Professor Lorsch. "There's so much churn and uncertainty, boards need to make decisions about the time horizon in which they are going to operate."

A board that clearly articulates its objectives, Professor Lorsch says, will attract the shareholders it wants, including those who are willing to entertain a longer time horizon. For Delphi, which is in a cyclical industry that is also facing global restructuring, more patient shareholders — and a patient board — willing to stick with a long-term vision are a necessity. +

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