

FMConsult Compliance Solutions: Industry Briefing

Behavioural Aspects of Boards
Presented by Margaret Cullen, FMConsult

Role of Board

Three key roles

- Strategy: influencing and monitoring implementation
- Control: over management
- Service: Advice and counsel to executives, access to scarce resources

Fundamental Principles of Governance

- Accountability
- Probity
- Transparency

Development of Corporate Governance Code

- Transparency (disclosure)
- Accountability
- Internal controls
- Board composition and structure
- Independent directors
- Performance-related executive pay
- Rights, expectations of shareholders
- Behaviour of shareholders (esp institutional shareholders), more proactive, less passive

Why should we consider the behavioural aspects of Boards?

"Corporate governance, whilst improving the processes and systems of analysis, does not replace the value of corporate quality, reliability and culture. The tangible cannot override the intangible; the thoroughness of structure and the frequency of debate cannot diminish nor replicate the board's dependence on individual integrity and the comfort of trust" (Long, Dulewicz and Gay, 2005, p.675)

Why should we consider the behavioural aspects of Boards?

Dynamics of the boardroom

- Boards: organisational teams
 - Share characteristics with many other kind of teams
 - Complex issues
 - Potentially ambiguous task and role situations

“Those directors and officers on the inside of board meetings would generally agree that the quality of the interactions among the participants – or ‘boardroom dynamics’ – is a crucial variable in effective decision-making and achieving other desired outcomes” (Letendre, 2004, p.101)

Why should we consider the behavioural aspects of Boards?

Three areas requiring attention:

1. *The independence of judgement, competencies and **behaviours** of the chairmen of the board – in short the ‘selection’ of the chair, not merely the ‘separation’ of chair and CEO.*
2. *The **behavioural** ‘posture’ of the CEO within the boardroom.*
3. *The effectiveness of individual directors, including their independence of mind, **competencies** and **behaviours**, not just their ‘regulatory’ independence.*

Leadership and Corporate Governance: The Chairman

- Leadership style of the chairman is fundamental to boardroom effectiveness
- The chair should represent an individual who can:
 - *lead the setting of the agenda,*
 - *run meetings effectively,*
 - *control discussion appropriately,*
 - *manage dissent,*
 - *work towards consensus,*
 - *communicate persuasively with colleagues and management, and, most importantly...*
 - *set the tone and culture for effective corporate governance*

Leadership and Corporate Governance: The CEO

- Ineffective CEO:
 - Strong control and influences over the board members
 - Influences selection of a board and chairman
 - Selects those who would not challenge the CEO's authority
- Where CEO does not promote a strong and engaged board...guilty of restricting the effectiveness of the board

Leadership and Corporate Governance: Non-Executive Directors

- Role of independent directors – demanding:
 - Ensure compliance with ever-evolving regulations
 - Head off executive wrongdoing at pass
 - Appease shareholders and stock exchange’s hunger for strong short-term results
- Making progress in past decade but...
 - **“Having to operate in a post-enron world has also produced some negative and unintended consequences for boards – the most critical one being director’s inability to be leaders who focus on ensuring the long-term success of their companies”** (Lorsch and Clarke, p.106)

Leadership and Corporate Governance: The Board as a Whole

- Board must:
 - Balance their function as compliance officers with their function as shapers of the future
 - Lead from the boardroom
- Taking the long-term view:
 - Clarity on board and management roles
 - Exercise their broad knowledge and accumulated wisdom about a range of business domains – finance, strategy, marketing, technology
 - Be there for management but push them to address company's future
 - Encourage leadership not just from the boardroom but within it

Factors that build collective Board strength

1. Personality and style of the chairman and CEO, including the structure of the chairman/CEO roles
 - Separation of role of chairman and CEO
2. People involved:
 - Composition of the board
 - Director selection process
 - Role of NEDS – nose in....finger out
3. Culture or climate of board meetings:
 - Whether openness and frankness are encouraged or discouraged
 - Size of the board
 - How decisions are made and the agenda is set
 - Relationships among directors
4. Degree of common purpose:
 - Clarity directors experience about their roles

What to do

Nomination committee should focus on:

- competency as board members
- rather than the regulatory independence of potential candidates

In selecting board members:

- a) perform “*a thorough assessment of the independence, competency and behaviours of the current board*” and
- b) perform an assessment of “*the gaps*” within the board to select the appropriate board members

Trends in Boardrooms of US and UK Public Companies

1. Boards are becoming more independent of management
2. Power is being transferred from CEOs to board committees
3. Outside directors are being required to do a more professional job
4. It is becoming more difficult to recruit experienced NEDs

What makes great Boards GREAT?

- Building an effective board – Best bets for success:
 - Create a climate of trust and candor
 - Information
 - Rotate board members
 - Eliminate polarizing factions
 - Foster a culture of open dissent
 - Dissent does not mean disloyalty
 - Utilize a fluid portfolio of roles
 - Push executives to challenge their own roles and assumptions
 - Ensure individual accountability
 - Give directors tasks that require feedback to the board
 - Evaluate the board's performance
 - Go beyond reputations, resumes and skills
 - Look at initiative, roles, participation in discussions and energy levels