



THE BOARDROOM BALANCING ACT



► ANN-MAREE MOODIE

TO BE EFFECTIVE IN ITS ROLE, A BOARD MUST BE ABLE TO SET THE COMPANY'S STRATEGIC DIRECTION, IDENTIFY AND MANAGE RISK, MONITOR PROGRESS TOWARDS THE COMPANY'S LONG-TERM GOALS AND PROTECT THE INTERESTS OF SHAREHOLDERS. INTEGRITY, INTELLIGENCE AND A KEEN SENSE OF RESPONSIBILITY ARE VITAL QUALITIES IF INDIVIDUALS ARE TO BALANCE THE COMPETING DEMANDS AND OPERATE EFFECTIVELY IN THE BOARDROOM.

In his many essays analysing management practices, Peter Drucker often highlighted the limitations of corporate governance warning that boards were at risk of becoming "anachronistic appendages" and "tired fictions". Although he was writing in the 1950s, Drucker's perspective on board work remains fresh and relevant today, especially during the past five years of corporate scandals here and overseas.

In the analysis of the collapse of Enron, WorldCom, HIH and One.Tel, corporate governance specialists could have cited Drucker when he stated: "The erosion of the Board of Directors is rooted in profound causes: the much publicised divorce of ownership from control which makes it absurd that the business enterprise be directed by the representatives of the shareholders; the complexity of modern business operations; and, perhaps most of important, the difficulty of finding good

(people) with the time to sit on boards and to take their membership seriously.”

BOARD VERSUS EXECUTIVE FUNCTION

Academic research on corporate governance has focused traditionally on the legal, financial and fiduciary duties of a board. This is an understandable position given that corporate governance is defined often as *the system by which companies are directed and controlled*. But a distinguishing feature of this process is a separation of control between the board and the executive team. The board drives the strategic direction of the organisation, monitors risk and reviews the performance of the chief executive and the senior management team. The executive team, by comparison, is charged with the day-to-day business of managing the operation.

The two groups – the board and the management team – work together, but have two very different roles. The distinction between the board and the management team is the crux of good governance and it is the essence of an effective board. It follows, therefore, that the way the board members behave – individually and as a group – is at the core of what it means to be ‘good’ board.

“A board of directors is not intended to duplicate the management and professional structure of a company”, according to corporate governance academics Ada Demb and Friedrich Neubauer. “Outside directors are much less familiar with the company and its industry than in-house management. Executive directors are primarily involved with the running of the business, and some observers have questioned whether they can extract themselves from their business responsibilities and govern without becoming advocates for their own portfolios. *Somehow a board must be constituted and equipped so that it can contribute judgments that are both critical and independent.*” (Italics author’s own).

AN EXPANDING ROLE

In the past five years, as a result of international and domestic corporate collapses, it has become obvious that corporate governance does not solely concern the legal and financial frameworks within which board members work. Instead, it is

THE DISTINCTION BETWEEN THE BOARD AND THE MANAGEMENT TEAM IS THE CRUX OF GOOD GOVERNANCE AND IT IS THE ESSENCE OF AN EFFECTIVE BOARD.

about the type of people who populate the board table and how they conduct themselves in their roles as board members.

The board of Enron, for example, was comprised of people with highly-regarded reputations in business and academe. Yet as Bethany McLean writes in her analysis of the scandal, *The Smartest Guys in the Room*, these people also illustrated the dark side of human behaviour. “[The collapse of Enron] is a story of human weakness, of hubris and greed and rampant self-delusion; of ambition run amok; of a grand experiment in a deregulated world; of a business model that didn’t work; and of smart people who believed their next gamble would cover their last disaster – and who couldn’t admit they were wrong.”

Locally, the collapse of HIH is also a pertinent example of how corporate governance is more about the way in which people conduct themselves than it is about legal or financial compliance. In his three-volume analysis of the failure of HIH, Royal Commissioner Justice Neville Owen said: “HIH is a reminder, if one is needed, that a drastic fall from grace can occur if those in charge lose their way.”

RATING BOARD MEMBERS

Boardroom behaviour remains a new area of interest within the field of corporate governance and one which is little understood. It is often shunned as being a ‘soft’ area of study. Unlike the more traditional corporate governance specialities of law and finance, boardroom behaviour is difficult to quantify and to measure. In order to understand human behaviour in the boardroom, it is necessary to source other fields of study such as psychology, motivation, group dynamics, decision-making and ethics, all of which are hard to quantify.

But if we accept as our starting point that corporate governance is about the people who govern the organisation, it follows that we

must then ask ourselves a series of questions relating to board composition and selection protocols, board performance and succession planning. How are board members making decisions? Do board members participate in debate, and if so, what is the quality of their contribution? What is the relationship between the chairman and the chief executive?

INDEPENDENCE IS VITAL

In his observations on boards, Peter Drucker maintained that boards will not become redundant because companies will always need an “organ of review, of appraisal, of appeal”. He wrote: “Somebody has to approve the decision on what the company’s business is and what it should be. Somebody has to give final approval to the objectives the company has set for itself and the measurements it has developed to judge its progress towards these objectives. Somebody has to look critically at the profit planning of the company, its capital investment policy and its managed expenditures budget.” In short, boards must be comprised of people who can think and act independently.

The ability to be independent – to have a thorough, in-depth knowledge of the company and its business whilst remaining detached in order to put shareholders and stakeholders first – is the most important skill of a board member. However, ‘independence’ in the context of corporate governance is ill-defined by regulators and is therefore often misunderstood by practitioners.

The guidelines on best practice published by the ASX Corporate Governance Council emphasised the need for a majority of ‘independent’ members of a board. Yet the ASX defined ‘independence’ according to a series of material criteria while simultaneously asking board members to display “unfettered judgment”. *Principle 2* states: “an independent director is a non-executive director [who] is independent of

management and free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the exercise of their unfettered and independent judgement”.

This conundrum has only served to confuse the debate on how board members should behave. It takes courage to put an opposing view and it takes maturity to accept a better argument. Until the ethos of the boardroom changes to encourage a high level of true debate without fear of it costing offers of future board seats, board members will remain tempted to follow the majority opinion.

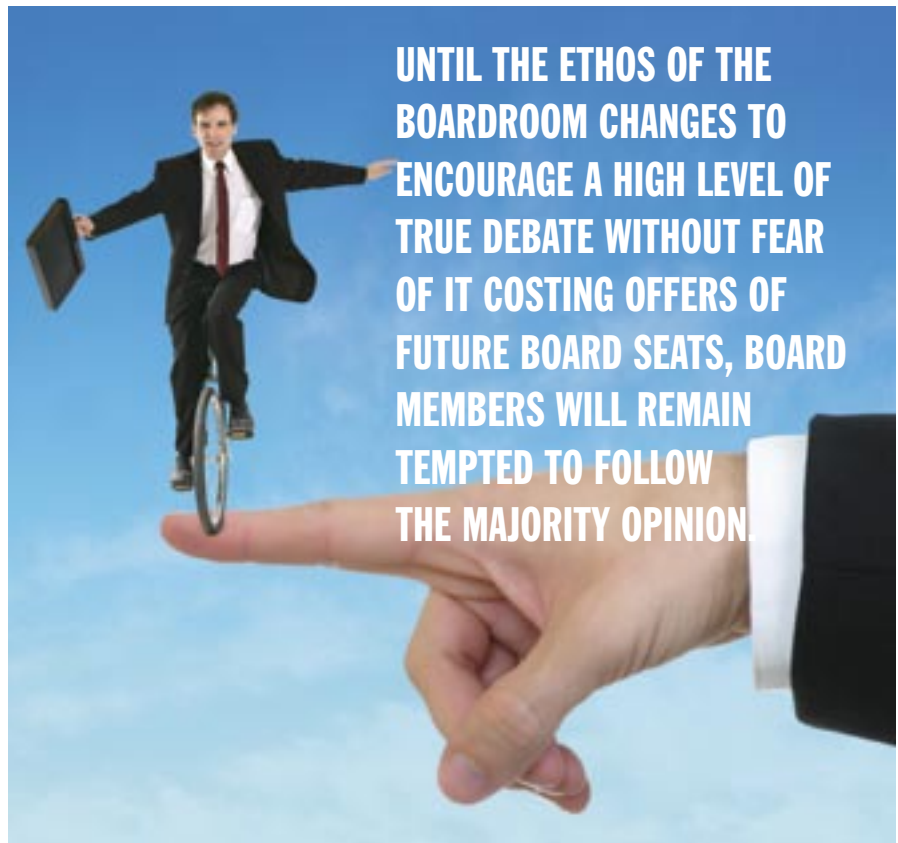
THE RIGHT QUALITIES

In order for a board to be defined as ‘good’ or ‘effective’, it is becoming increasingly accepted that the board must be comprised of a group of people who collectively have the skills and experience necessary to guide the company with wisdom. In addition, these people must be self-determined, feisty individuals who are dedicated to the concept of governance and who don’t consider a board seat a reward to good service at the end of their executive career.

If a board is composed of such a group of people, the onus falls on the chairman to ensure that there is ample opportunity for the group to debate issues and to focus on the strategic opportunities. It is a waste of time to gather exemplary people to govern a company and then fill the agenda with items concerned with the minutia of daily management. (If any management matters do need to be discussed by the board, it might be more efficient to delegate them to a board sub-committee). Motivated, clever people need to be intellectually stimulated and valued for their opinion if a board is to get the best from them, and indeed to keep them as members as well as to attract people of a similar quality in the future.

TAKING THE LONG VIEW

Peter Drucker contended that boards were akin to a ‘Supreme Court’, meaning that boards view the organisation in the context of the business and the industry as well as the company’s broader perspectives. In doing so, it learns to accept and to manage uncertainty and to consider the company in the context of



UNTIL THE ETHOS OF THE BOARDROOM CHANGES TO ENCOURAGE A HIGH LEVEL OF TRUE DEBATE WITHOUT FEAR OF IT COSTING OFFERS OF FUTURE BOARD SEATS, BOARD MEMBERS WILL REMAIN TEMPTED TO FOLLOW THE MAJORITY OPINION.

wider stakeholder demands, such as corporate social responsibility. “Somebody has to watch the spirit of the organisation, has to make sure it succeeds in utilising the strengths of people and neutralising their weaknesses, that it develops tomorrow’s managers and that its rewards to managers, that its management tools and management methods strengthen the organisation and direct it towards its objectives,” said Drucker.

A COMPLEX TASK

More than 200 years ago, when the company was created, the role of the board was to act in the interest of investors, to make sure monies were spent appropriately. The management of the affairs of the company is today much more complex, with an increasing number of stakeholders including shareholders, regulators and government as well as others impacted by the company who come under the category of ‘corporate social responsibility’. Despite this, the purpose of the board remains the same: accountability and responsibility to the company.

As Catherine Walter wrote to her chairman Graham Kraehe during the National Australia Bank rogue trader scandal: “The board is a governance body, not a club. Each of us has duties individually, not to each other, but to the stakeholders.” **NA**

REFERENCES

- Drucker, P., *The Practice of Management*, Butterworth Heinemann. (First published in 1955).
- Moodie, A., ‘The Meaning of Independence’, *Keeping Good Companies*, September, 2004.
- Moodie, A., *The Twenty First Century Board: Selection, Performance and Succession*, (AICD: 2001).
- Demb, A., & Neubauer, F., *The Corporate Board: Confronting the Paradoxes*, Oxford University Press, 1992.
- Principles of Good Corporate Governance and Best Practice Recommendations* (Australian Stock Exchange Corporate Governance Council 2002)

Ann-Maree Moodie is managing director of The Boardroom Consulting Group Pty Ltd and author of three management books. Her articles appear in key business and management journals. She lectures on corporate governance at the Australian Graduate School of Management and the University of Technology, Sydney and is completing her PhD in corporate governance at Macquarie Graduate School of Management. Visit <www.boardroomcg.com>.