

A photograph of a man in a dark suit and blue shirt, seen from behind, sitting at a long conference table. He is looking towards a group of other business professionals seated around the table. The setting appears to be a formal meeting or boardroom. The background is slightly blurred, focusing attention on the man in the foreground.

[what makes a] good board?

The role of the board has been under the microscope in recent years and there is no doubt that the responsibilities of a board member have changed markedly. Ann-Maree Moodie* investigates how successful boards operate.

When Thomas Grant joined a family-owned building and construction company in regional NSW as the Chief Executive Officer, he did not expect the experience to be an exercise in how poor corporate governance practices can destroy an otherwise prosperous company.

The company was an example of the worst mistakes that a family-run enterprise can succumb to: a dominating Chairman, a compliant Board overpopulated by family members, a severe lack of financial skills, infighting for power and a belief that the company was to serve the personal financial interests of the family.

Grant, who is unrelated to the family, managed to turn the company to profit, but it was too late. Poor governance structures and processes have meant the company will shortly close.

"The outcome of these practices is that the companies can no longer trade as going concern," says Grant, who asked for his identity to be disguised. "The main reason is that that there was a lack of understanding of the decision-making process and how that affects cash flow.

"Cash flow is the most important aspect of business management, and if I could pinpoint one thing, poor cash flow management as a result of the inability of the board to understand their legal and fiduciary duties, has really been the downfall of this organisation."

Corporate governance seems to be the latest buzzword in business, and is often associated with large local and international corporations such as HIH, NAB, Enron and World Com.

In difficult business cycles, such as an economic downturn or a recession, the board is often blamed if a company collapses. "What was the board doing?" is a common question.

The last great debate on the role of

You need to think twice about accepting a board position today, it's no longer long lunches and no responsibility.

the board occurred in the early 1990s following the entrepreneurial excesses of the 1980s and the subsequent recession of 1987. This was a time when the former chairman of AMP, Stan Wallis, called for a balance between "conformance and performance".

The topic lost momentum until 2001, when corporate governance re-emerged in managerial jargon to assist in the diagnosis of the corporate collapses of One.Tel, HIH, Ansett, Harris Scarfe.

The HIH Royal Commissioner, Justice Neville Owen, in his erudite three volume report on the failed insurer called for a re-examination of governance structures and processes.

Soon after, the Australian Stock Exchange published its Principles of Good Corporate Governance and Best Practice Recommendations.

This document was complemented by the United Kingdom's Higgs Report into the independence of company directors, and the Sarbanes Oxley Act in the United States concerning auditor independence.

Despite all this research, what does corporate governance mean?

Corporate governance is a term used to describe the system by which companies are

directed and managed. A core element of this system is a separation of control between the board and the executive team.

A board influences how the strategies of the company are established, how risk is monitored and reviews the performance of the chief executive and other executives. In boardroom parlance, the key role of the board is to "hire and fire the chief executive".

Academic research on corporate governance is primarily founded on the legal and fiduciary duties of a board rather than examining the work of board members in social, political or cognitive contexts.

According to The Registrar of Aboriginal Corporations, fiduciary duties can be summarised as:

- the duty to pay attention to the

A board influences how the strategies of a company are established, how risk is monitored and reviews the performance of the CEO.

corporation's affairs

- the duty to act in good faith and in the interests of the corporation as a whole;
- the duty to exercise powers in accordance with the corporation's constitution;
- the duty to avoid any conflicts of interest; and
- the duty not to make improper use of information or position.

Graham Bradley, the former managing director of Perpetual Trustees who now serves as a non-executive director and chairman of boards in the public, private and non-profit sectors, says the key to an effective board is the type of people chosen as its members.

"Good governance is a function of accountability, having people who have a sense of responsibility, who have a clear sense of who their stakeholders are and whose interests they are protecting or promoting," says Bradley.

"Good governance is about having a structure that allows full and frank discussion, open sharing of relevant information and a structure in which people are accountable to somebody other than themselves.

"So the essence of good governance is answerability. Hence, the role of the board is to ensure that the managers, who run a company who are answerable to the board, and the directors who are answerable to the shareholders. The challenge in corporate governance is to make that structure work and make it more perfect."



A private brawl went very public

An almost unprecedented public battle erupted earlier this year when National Australia Bank Board dissident director Cathy Walter battled other non-executive directors after she questioned the integrity of an investigation into the rogue trading scandal. Market analysts and investors were not impressed...

Bradley, who was a member of the group formed to review the implementation of the ASX guidelines, says no matter how effective the governance structures and processes, the qualifications and experience of the board members, and their ability to work together effectively, are more important.

The board of Enron, for example, was populated with people who came from stellar backgrounds in business and academe. The board of the National Australia Bank also comprised highly-regarded people. Yet both boards, and their companies, imploded in their own way. What went wrong and how can a set of guidelines help?

"I think the ASX guidelines should

help to make the conditions for good governance more prevalent," says Bradley. "But they can't guarantee good governance because at the end of the day that's the function of the qualities of the people you have on the board.

"You need people who have a sense of responsibility and a lot of personal integrity. They must be competent to understand the business and the financial issues that might impact upon the value of the company and the sustainability of its earnings and its services. Ultimately, if you have people who are business savvy, then you'll have good governance."

The problem is that none of the international research, legislation, regulations and guidelines has been able to define the ideal board member.

"If the ASX guidelines have any failing it is that they don't have enough to say about the qualities of the individuals that you need to make an effective board," says Bradley.

"I think Warren Buffet put it very succinctly in one of his recent annual reports where he said 'all the governance structures in the world won't give you good company performance. What you need are individuals of integrity who value their reputation and are savvy business people'."

But Buffet's remark does not go far enough. What does it mean to be a "person of integrity"? How does such an individual define themselves as a person of integrity, and how do the other board members judge them to be so?

the changing role of company directors

"As a new non-executive director my observation has been that the role is changing quite rapidly," says Graham Bradley, non-executive director of Stockland Corporation, MBF Australia, Singapore Telecommunications, HSBC Bank Australia and the Queensland Investment Corporation and chairman of the Film Finance Corporation of Australia and of the Garvan Research Foundation, Sydney

Community Foundation. "We're undertaking the great corporate governance experiment at the moment with most boards querying whether they're spending their time the right way, whether directors are focused on the right issues, whether they're spending the right about of time on different categories of issues and whether there are smarter ways for them to add value and to fulfill their functions properly.

"Secondly, a lot more time will be involved in the role. As a new director, I'm spending a lot more time than I expected on committees and also, because of the immediacy of email communication, a great deal more time between board meetings and committee meetings keeping myself abreast of issues. In fact, I would say in some cases I spend more time on the board between meetings than we ever do at meetings."



Graham Bradley – non-executive director.

Even more tricky is the question of how does this group of people work together to make the decisions on behalf of shareholders or stakeholders that fulfill the purpose of the organisation, whether it be sustaining wealth or promoting a particular interest?

Thomas Grant believes that regardless of the purpose of the board, the most important element is that its members are able to act for the greater purpose and have the self-awareness to set aside personal interests.

"I think the composition of the different personalities on the board makes a good model in some companies – but not necessarily the one that I'm in which is made up of a variety of family members including children of the founder, as well

as cousins and grandchildren," says Grant.

"Where you have a mother who is the managing director and son who is another director, you have vested interests in protecting [the offspring or other siblings].

"The most important lesson I've learned from this experience is that emotions really should be left outside the door of the boardroom. The members of all types of boards must realise that to be effective they must be able to differentiate between emotional reactions and good decision-making based on a fine, rational analysis of the risks."

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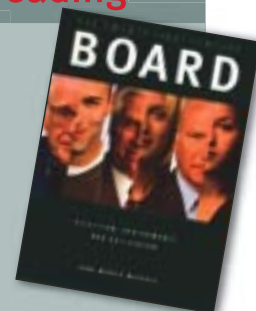
** Ann-Maree Moodie is the Managing Director of The Boardroom Consulting Group. She is presently completing her PhD thesis examining board members' work as a relational activity.*

further reading

>> ***The Twenty First Century Board: Selection, Performance and Succession.*** Ann-Maree Moodie, AICD, 2001

>> ***Conversations with a New Director.*** Henry Bosch, AICD, 1997

>> ***Back to the Drawing Board: Designing Corporate Boards for a Complex World.*** Colin B Carter and Jay W Lorsch, Harvard Business School Press, 2004.



your company and the law – an ASIC overview

If you are a director or secretary of a small company, you need to follow the requirements set out in the Corporations Act 2001. The Australian Securities and Investment Commission (ASIC) is the company law watchdog. They've put together a guide to let you know about the most important things the law requires directors and secretaries of small companies to do.

The law imposes a number of legal obligations on company directors and secretaries. Note that ASIC warns that even if you appoint an agent to look after the company's affairs, you – not the agent – may still be held responsible for those legal obligations.

What does the law expect of you personally?

As a director, you must:

- be honest and careful at all times
- know what your company is doing
- take extra care if your company is operating a business because you may be handling other people's money
- make sure that your company can pay its debts

- see that your company keeps proper financial records
- act in the company's best interests, not just in your own interests, even though you may have set up the company just for personal or taxation reasons, and
- use any information you get through your position properly and in the best interests of the company. It is a crime to use that information to gain, directly or indirectly, an advantage for yourself or for any other person, or to harm the company. This information need not be confidential; if you use it the wrong way and dishonestly, it may still be a crime.

If you have personal interests that might conflict with your duty as a director, you must generally disclose these at a directors' meeting. This rule does not apply if you are the only director of a proprietary company.

What work must a director do?

You and any other directors will control the company's business. Your company's constitution (if any) or rules may set out the directors'

powers and functions.

You must be fully up to date on what your company is doing:

- Find out for yourself how any proposed action will affect your company's business performance, especially if it involves a lot of the company's money.
- Get outside professional advice when you need more details to make an informed decision.

Avoid any company where someone offers to make you a director or secretary on the promise that 'you won't have to do anything' and 'just sign here'. You could be exposing yourself to many legal liabilities.

You must not act as a director or secretary (or manage a company) without court consent if you:

- have been declared bankrupt, or
 - have been convicted of various offences such as fraud or offences under company law, such as a breach of your duties as a director or insolvent trading.
- If you have been convicted of one of these

offences you must not manage a company within five years of your conviction.

If you become bankrupt or are convicted of a relevant offence at a time when you are a director or secretary then you automatically lose that office. In such cases, the company must notify ASIC that you have ceased to act as a director or secretary of the company.

Finally, you are unlikely to get into trouble if you:

- are honest;
 - are open with colleagues;
 - do the required homework;
 - get advice or more information when you are in doubt; and
 - give the interests of the company, its shareholders and its creditors top priority.
- Need more help? For help about your duties as a director contact the ASIC Infoline at infoline@asic.gov.au.

