Stronger Committees, stronger centres.

Paper on Board Governance delivered by Ron Anderson at the ACE(Vic) Conference: ACE at the Crossroads.

In my conversations with Mark Russell as a lead-up to preparing this paper for you today, we discussed a focus that dealt with some of the issues associated with the internal business of boards and committees.

As a result of this conversation and other factors I have decided that rather than talking to you about the Carver Governance Model, even though this approach would have provided a sound platform for addressing many of the internal issues of boards, to do that would have meant discussing in detail the many board self-management issues that arise, often due to a lack of clear policy, that tend to weigh boards down.

This conference to day is not the forum for exploring those elements of Carver.

Instead, in the time we have today, I have chosen to take another focus with you about governance and explore **the no less important** topic of how your board might approach the role of becoming a **Learning Board** to position itself to address C21 governance issues.

Besides providing you with an opportunity to reflect on how you might adopt a new governance paradigm to guide your organization this presentation may also offer some insights for you to consider about how you might re-focus your own thinking as a board member, particularly in relation to current practices around operational issues that inevitably dominant many board agendas.

Today we have to be the master's of our own governance destiny and one of the key elements we have at our disposal as board members is our ability to identify, plan and act on our own personal future development needs to better position

ourselves to face the challenges to our organization's future that will inevitably confront us in our board role.

Jeffrey Sonnenfeld a prominent US writer on Governance issues has written after reviewing the governance processes underlying the collapse of ENRON, Tyco and World Com that those responsible for governance mostly concentrate on rules, procedures, and things such as the composition of committees.

In his comparison of boards that failed with those that succeeded he found that there was no significant difference in the formal aspects of governance between good and bad boards.

For example, directors of failed companies were as likely to attend meetings regularly as those from successful companies.

Such things as training, and experience to analyse complex financial issues; the age of the board members; the size of the board etc. None of these factors distinguished between good and bad performance.

Rather what brings boards and companies down in his view is not tangible, visible or measureable.

What brings boards and companies unstuck is dysfunction of purpose within their social system.

The key according to Sonnenfeld is not structural, it's social. What distinguishes exemplary boards is that they have robust, effective social systems with a virtuous cycle of respect, trust and candour.

Margot Cairnes in her book 'Boardrooms That Work – A guide to board dynamics' (2003) written for the AICD believes that the primary message behind Sonnenfeld's finding is that human social relationships are a key determinant in the decision-making processes and procedures in any organization.

The best way that I am aware of, for building strong relationship capacity is through creating and nuturing a positive learning

environment or culture to build social capital within an organisation.

I want to propose that building a learning culture where the board is able to understand and redefine their governance challenges starts with the board evaluating itself so that it is in the best possible position to plan and act on its future needs.

In other words boards need to start to engage in a continuous learning and professional development process.

To do this Boards and CEOs must assess whether or not their member's skills; and the policy structures that are currently in place, are going to effectively help achieve future organization goals and challenges.

The professionalism of directors, both collectively as well as individually, is and will increasingly becoming the focus of government, stakeholder and media attention.

For the last decade a set of traditional legislative and compliance driven board procedures and systems has dominated the governance debate, but a much more general question is now being asked, which is simply:

'How effective is your board?'

This is a difficult question to answer in any objective way because there is no easy or definitive method for appraising a board's performance.

Boards of directors today face an increasingly demanding set of responsibilities and challenges, the complexity of which can be seen in the seemingly contradictory pressures boards have to deal with.

In 1995, the Chartered Institute of Company Directors (IoD) in the UK, following extensive research, published the first ever

standards of the board. This was extraordinary for two reasons; firstly The UK Institute of Directors was founded in 1903 and granted Royal Charter in 1906, so it took nearly 100 years to state what it was that a board actually did.

Secondly and more positively, the 1995 Standards identified new thinking and the beginning of good practice for boards and set in motion world-wide discussions about the roles and tasks of a board.

Before we look at those standards, however, I would like to explore briefly the concept of the 'unitary board', because it underpins so much of the governance structure that we in Australia and most other commonwealth countries work by.

The Unitary Board model assumes, backed by legislation and the law, that **all directors are equal** and must accept the same responsibilities and liabilities for the performance of the enterprise.

It also assumes that performance and conformance within the unitary board is such, that the interests of the members (Shareholders) and other stakeholders are heard and protected.

The standards referred to a moment ago that were identified by the IoD UK for Board's using the Unitary Model have been described by Garratt (1996) in his book:

'The Fish Rots From The Head', as the four '**Directorial Dilemmas**'

They are that: (OHP 1).

1. The board must simultaneously be entrepreneurial and drive the business forward while keeping it under prudent control.

2. The board is required to be sufficiently knowledgeable about the workings of the organization to be answerable for its

actions, yet to stand back from the day-to-day management and retain an objective, longer-term view.

3. The board must be sensitive to the pressures of short-term local issues and yet be informed about broad trends and competition, often of an international nature.

4. The board is expected to be focused upon the commercial needs of its business while acting responsibly towards employees, business partners and society as a whole.

These are very broad and demanding expectations for any board, and requires from its membership, diversity, in terms of breadth and depth of experience, knowledge, attitudes and skills, which cannot be expected from any **single** individual, no matter how powerful.

It is for this reason that **we have** a *Board of Directors* or management committee, because the work of a board is a *collegiate activity* – where, **all members are equal**.

There should be no one powerful individual dominating a board, because over time they inevitably pass their 'use-by date' and can become a negative influence on the organization.

We are all aware that constant change is a dominant feature of almost every facet of personal and business life these days. Sometimes referred to as "permanent white water" where new and sometimes unprecedented challenges and crisis are occurring continually.

For an organization to have a future, to survive and to grow, the rate of *learning* for the organization has to be **equal to**, or **greater than**, the rate of change in its environment.

Effective leadership, therefore, means that an organization has to be actively engaged in learning at all levels from the strategic and policy level through to the operational.

For this to happen, a learning culture needs to be created within the organization.

Which brings us to Board Leadership!

For boards to champion an organizational learning culture they must see themselves as being Learning Boards, which necessitates the board focusing on its own learning needs.

One way to begin to conceptualize this is through this simple diagram which highlights the sharing of some of the basic responsibilities of both the chairman and the CEO. (OHP2).

What is important here is that the board address the issues of 'who does what' and 'where scarce board resources are best deployed'.

In addition to clearly differentiating the roles of the board chairman and the CEO it is also important that all the directors (lead by the chairperson) commit to engaging in a continuous learning process.

A Learning Board needs to commit itself to the idea of having three parallel streams of training and development underway simultaneously, which include: (OHP3)

1. The training and development of individual directors

2. The training and development of the board as an effective working group, and finally;
3. The continuous development of the enterprise as a whole.

We will only focus briefly on the first two of these three streams today.

How then do we start the cycle of building towards becoming a Learning Board that can better equip us to focus on and deal with future challenges?

We can begin by exploring the personal qualities required of directors.

Mark Watson, Corporate Governance Executive with the IoD(UK), writing in the journal <u>Management Skills and Development</u> (Jan '98) believes the personal qualities of directors which relate to specific aspects of company direction can be classified into six groups. (OHP4)

They are:

1. Strategic perception and decision-making
2. Analytical understanding
3. Communication
4. Interacting with others
5. Board management
6. Achieving results

While acknowledging that no one director will necessarily possess all of these qualities, they should form part of the complementary personal knowledge and skills mix of the board

members and should be identified and taken into account in order to build an effective team.

Collectively then, the board should be made up of individual members who have:

A Strategic perception and decision-making ability; sometimes called the 'helicopter perspective', and entails the ability to stand back from the immediacy of any given situation.

Applying imagination and judgement, a director must be able to produce a clear and consistent picture of the company's long-term future and not be side tracked by short-term issues.

Analytical understanding; meaning the capacity to insist on sufficiently detailed, reliable and relevant numerical and other information as a basis for challenging assumptions and identifying the strengths and weaknesses of proposals.

Communication; both oral and written, as well as being able to listen effectively, so as to recall and take into account all key points.

Interactive ability; so that all directors have the ability to foster co-operation and effective teamwork, to persuade and motivate and yet act with sensitivity and flexibility when appropriate.

Board management; is about all directors having the ability to plan and use their time effectively. Directors must be able to effectively delegate and monitor and must be able to appraise and be appraised. Directors must have their own skills and personal qualities continually developed.

Achieving results; directors must have the energy and determination to carry out their duties effectively at all times.

A director must have sufficient personal independence and integrity to assess all proposed courses of action and the necessary business sense to maximize the organization's commercial position.

These then are both the personal and collective qualities that Watson believes directors should bring to their role.

Watson also identified what he called the key areas of directors' **knowledge and understanding**, which only when matched up and put side by side with the individual qualities and abilities of fellow directors is the board able to begin to appraise individual and board performance effectively.

This' knowledge and understanding' Watson referred to is grouped into three categories: that which is: (OHP5)

- *specific to the board;*
- *specific to the company;*
 and
- *relating to the business environment.*

Stated in a very general way each of these areas translate into:

Knowledge specific to the board includes:

- Corporate governance –conformance issues such as regulatory, fiduciary, legal and ethical duties;

- Board roles, relationships and processes – including leadership, group roles and dynamics, decision-making, problem-solving, communication and networking;
- Board standards of good policy and practice (following sound business practices and displaying honest behaviour);
- Corporate finance and accounting principles and practice.

Knowledge specific to the company:

- Evaluating strategic options and risks – including market strategy, technology strategy, HR strategy, etc;
- Strengths and weaknesses of the company;
- Selection, appraisal and development of directors;
- Company Memorandum and Articles of Association.

Knowledge relating to the business environment:

- Contemporary thinking and developments – in business leadership, management practices and organizational behaviour;
- Public affairs and corporate communication;
- Political, economic, social, cultural and technology influences;
- Key trends in the company's environment.

From Watson's perspective, a board that can competently face future challenges, must have sitting around the table a group of individuals who possess a mix of the personal qualities listed above, being used collectively by them in conjunction with the three knowledge areas we have just outlined.

So what then are some other preconditions for the successful development of a learning board?

Many writers in the field believe there are several critical pre-conditions if the board development process is to be successful and sustainable.

Firstly, the board members must recognize the difference between managing and directing.

Secondly, the board must appreciate the need to 'benchmark' the position of the board as a working group, and themselves as individual board members, in terms of where they are now, and where they wish to be for the future.

Performance appraisal is not just something for operational staff only, boards today also need to have 'in-place' their own performance appraisal mechanisms.

The 'differential' measures or 'gap analysis' arising from measuring existing performance can begin to provide the foundation and direction for any development process.

Thirdly, the chairman must take responsibility for the board development process. The Chair has ultimate responsibility for ensuring that directors are trained to the desired level of competence, and then maintaining a level of continuous development.

The essential building blocks that need to be 'in-place' for the board development building cycle include:

- *Understanding and commitment to the unitary board model* where there is clarity about the differing roles of the chairperson and the chief executive. The board of directors may be the 'mind' and 'will' of the organization, but the

chairperson is the 'boss of the board' and the CEO is the 'boss of the organisation's operations'.

- *A good director selection process:* Because board membership requires such a significant investment of personal time and energy, it is important to find candidates with industry and life experience who can contribute in the areas identified as strategic needs, as well as care about the organisation's mission.

- *Commitment to arrange the organisation's affairs from the boardroom.* Directors must be adequately prepared on all agenda items, and the chairman must create sufficient time for questions, debate and consensus checking at meetings. Remember, the Board room is where the board does its business!

- *A chairperson who knows their job.* This means someone who can differentiate between the content of board discussion and can facilitate a process by which the chair can control and guide that discussion. Someone who can undertake board meeting preparatory work with the CEO to ensure appropriate documentation is clear and sent out on time. The chair must also have the stature, personal attitudes, skills and self-confidence to positively influence and manage the meeting process.

- *Ensuring proper strategies have been developed by the board.* At the minimum there should be clearly understood financial; policy and business strategies that are understood and support by all directors. The board, through the chair, must be responsible for ensuring that the organization strategies are being addressed and actively pursued by the CEO.

- Finally, *that effective use is being made of the board's time* within, and between, meetings by adhering to the agreed

agenda. Ensuring that any special projects are on the board agenda and vetted regularly so they can be accurately transmitted to the board's various constituencies if and as required.

.

How might you get the Learning Board process started in your organisation?

Development of individual directors is the cornerstone of the process for ensuring that the board members collectively are able to perform their duties and responsibilities to maximum effect and adapt to a changing environment.

Just as a brief aside, recruitment of new directors is an extremely important task for the board, because at the end of the day they are the source of board and organisational continuity.

Where an organization is recruiting a new director, the development process starts ideally at the induction stage that introduces the new director to the organization, to the people with whom they will be working and reviews what is expected of them in their new role.

This is a part of the process that is not always handled well, (the literature constantly reinforces the view that the induction and development of directors is most often done poorly), yet, if done well it can reduce the stress of moving into a directorial role.

It also increases the speed with which a new board member can begin making a significant contribution.

However, all this assumes, of course, that the board has taken time prior to induction to consider what skills and attributes it is seeking in a new appointment through a board profiling exercise.

This inclusion phase requires input from the rest of the board. Rapport, trust and credibility must be built so that the new director can be accepted by, and work with fellow directors and move towards a level of competence by gaining any necessary technical capabilities.

Individual development continues as directors are given fresh tasks and particular roles to enable the organization to cope strategically with identified issues in the operating environment.

Ideally a strategic professional development process will in time lead to competence being displayed across all directorial activities.

Again most commentators on governance see the development of a director as a cyclic and therefore a continuous process of learning essential for the survival and growth of the organization.

Implicit in any discussion about board development in relation to knowledge, skills and attitudes is the issue of competency.

A tool for identifying director and board competencies is this tool used by the former Australian Quality Council, it is a process to determine competence which contains four levels, with information,' being the first level and 'wisdom' being the fourth. (OHP6)

The four **Competency Levels** and definitions used here are shown in the following table: (based on the work of Tribus and Langford).

Information	I have heard of it. I am aware of it. I can recall information. I have been exposed to the information and can respond to questions and tasks, etc.
Knowledge	I understand and can explain it. I comprehend and understand what is being communicated and can make use of the ideas. I can translate the information into my own words and can make an example to demonstrate my learning. I can compare and contrast this information with other information.
Know-How:	I can do it. I have the ability to use the ideas, methods, concepts, principles and theories in new situations. I solve problems on my own.
Wisdom:	I can evaluate it and I apply it in the most appropriate ways. I have the ability to judge and appreciate the value of the ideas, principles and theories. I can discuss or debate an issue with information gained through application and back up my viewpoint. I can explain, give examples and teach this to someone else.

This table is offered only as a guide for directors to determine what personal level of understanding they may need to have in relation to the range of material they deal with regularly at board meetings.

However, a board wishing to become a 'learning board', should begin at the beginning and undertake a profiling exercise to determine what characteristics, such as age, gender and ethnic background, skills, knowledge and experience is available to them.

The organisation's strategic direction will also help in part to clarify the special skills and needs required of the board.

The process of board profiling is fairly straightforward, the hard part comes in deciding what elements of the attribute mix you need in the composition of the board to help move the organization forward and overcome future challenges.

I have drawn-up some examples of a matrix that could be used as a tool for assisting with the profiling exercise. It relates to the three knowledge areas identified by Watson.

(See hand-outs for later discussion).

What is important after the profiling exercise is completed is that the board adopt an 'intentional' learning strategy.

The following process in relation to intentional or group-directed learning developed by Wick and Leon (1993) and further developed by Hall (1998) suggests the following steps:

First the board must select a goal based on the' gaps' in the profiling exercise or the personal analysis.

Second, identify what is to be achieved: what aspect of board skilling is being focused upon and what level of understanding is being sought. (refer to competency table).

Third determine progress on a monthly or other regular basis. Can the board collectively or individual directors, demonstrate competency about the matter the board has selected to be competent about.

Fourth, review the learning process by reflecting and questioning.

Finally, when the board achieves the level of competency they have set out to achieve, it is time to go back to the next identified learning goal and commence the learning cycle again.

However, once identified in the context of the board's strategic and self-management requirements these attributes in most instances need to be nurtured in the existing board membership through a continuous learning approach to then build onto the continuous learning development process of the board.

Of course a pragmatic approach is to ignore the entire profiling exercise and recruit new board members with the skills required.

A worse option is to do nothing!

Adding more layers of expertise to the board to meet perceived needs does have a downside.

Not only is it becoming more difficult in the current social climate to find volunteers to recruit, there is also the research about the importance of social relationships to be considered that was referred to at the beginning of this presentation.

But there is also contemporary research emerging about optimum group size and its impact on effective decision-making.

While the trend internationally is toward smaller, more workable boards, the appropriate size of any board will depend on the organization and the work the board is expected to accomplish.

Recent work by Professor Simon Garrod of Glasgow University (Reported on by the ABC's Robin Williams in the Science Show) on group dynamics suggests that for good decision making the number 7 is a better number than say 12.

The Glasgow research shows that for groups larger than 7 the communication process seems to flip from an interactive consensus forming kind of process, to the non-interactive information transfer sort of process.

This research also looked at how people are influenced when they are making group decisions and how that relates to the kind of communication process that occurred in the discussion.

The main finding is that in a large group, people are very strongly influenced by dominant speakers, whereas in small groups you get quite the opposite result. In the smaller group dominant speakers appear to have no greater impact than anyone else.

So there appears to be a strong relationship between the size of the group holding the discussion and the formality of the discussion.

An interesting side-note to this research is that evidence from work being done with professional teams is that a professional group facilitator can actually make larger groups act more like smaller groups.

They do this by bringing people into the discussion that haven't been contributing which seems to alleviate, to some extent, the dominance problem that you get with the very large group. (Clearly this facilitation role is something that might be expected of a board chairperson anyway, irrespective of the group's size.)

To conclude, boards need to be developing from within their ranks, individual directors who have more than one of the desirable attributes outlined earlier to best position themselves

for dealing with and overcoming future organisational challenges.

When combined with a strong and effective social system based on respect trust and candour this mix would appear to be the way forward for an 'effective' 21 Century board or management committee.

Thank-you.