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Corporate Governance – Principles, Policies and Practices 3e

Chapter 15
Board Effectiveness
– building better boards

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Corporate Governance – principles, policies and practices

In which we consider:

- making a board effective
- director orientation and induction programmes
- director development, training, and updating
- directors' liabilities and indemnity.
- board information
- managing meetings, agenda and minutes
- communications with shareholders and other stakeholders

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‘Six C’s’ of board behaviour

- Commitment
- Character
- Collaboration
- Competence
- Creativity
- Contribution

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‘Six C’s’ of board behaviour

Commitment

- A commitment by every member of the board to the company’s mission, values and strategy

- Without a shared vision of the company’s future there can be no real commitment to success.

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‘Six C’s’ of board behaviour

Character

- Boards have a character
- Effective boards depend on the integrity of each director
- Their personal values reflect in the standing of the board and permeate the organization as a whole
- Companies have a character too
- Strong companies have strong characters.

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‘Six C’s’ of board behaviour

Collaboration

- Boards work as a team
- Effective team play calls for communication based on trust, reliance on others, and mutual respect
- Balance in deliberations means being prepared to question, to challenge with tough-minded discussion not group-think, but always open to others’ points of view
- Perseverance is sometimes needed
- So is enthusiasm - can be reinforced by a lightness of touch and occasional humour.

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‘Six C’s’ of board behaviour

Competence

- A well balanced board has the appropriate experience, skills and knowledge, which it draws on to ensure
  - confidence
  - reliability
  - excellence

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‘Six C’s’ of board behaviour

Creativity

- Creativity means challenging conventional wisdom
  - (thinking outside the box)
- Encouraging unconventional ideas
  - rather than resisting them
- Facilitating change

Creativity is the least appreciated hallmark of an effective board.

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‘Six C’s’ of board behaviour

Contribution

- An achievement orientated board strives to achieve the company’s full potential.

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Board effectiveness

"An effective board develops and promotes its collective vision of the company's purpose, its culture, its values and the behaviours it wishes to promote in conducting its business".

UK Financial Reporting Council (FRC)

- guidance on board effectiveness

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Board effectiveness

In particular it:

- provides direction for management
- demonstrates ethical leadership
- creates a performance culture that drives value creation without excessive risk
- makes well-informed and high-quality decisions based on a clear line of sight into the business
- creates the right framework for helping directors meet their statutory duties
- is accountable
- thinks carefully about its governance arrangements and embraces evaluation of their effectiveness."

UK Financial Reporting Council (FRC)

Director orientation and induction

A newly appointed director needs a proper induction programme to reduce the learning time taken before beginning to make significant contributions to board deliberations

- The quicker a new director masters this knowledge, the faster and the better the contribution to board discussion
- Chairman should brief new directors and ensure that the induction programme is adequate
- Experienced directors can act as mentors.

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Director training and development

- In the past few directors accepted the need for director training
- Now many corporate governance codes call for director training and performance evaluation
- The importance of professional education and training with continuous updating has become apparent, given the:
  - ever-changing aspects of global business life
  - rapid acceleration of new regulations, codes and legal requirements
  - litigious society that exists in many parts of the world.

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Director training and development

Formal external training courses

- In-house board development programmes
- Updating and briefing sessions for the board, or individual directors
- Relevant higher degree courses
- Experiential sponsorship programmes
- Mentoring
- Self directed learning and continuous self-
- Board experience

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Directors' liabilities and indemnity

- Unlike shareholders, directors' liability is not limited
- Suits against directors can come from shareholders, employees, creditors, customers, suppliers, regulatory bodies, or liquidators
- In listed companies, investor-led proceedings are most likely
- In private companiess customers, clients, or, employees are more likely sue
- Directors can be held legally accountable in their personal capacity
- Statute law may impose duties on directors under company, health and safety, environment, anti-corruption, consumer protection, employment or creditor protection laws.

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Directors and officers insurance

Class actions and contingency fees

- Legal actions can be brought against the company, the board, and/or individual directors
- Directors' personal assets can be at risk
- Directors can be held legally accountable in their personal capacity, but also for the actions of other members of the board or top management
- Claims can be for unlimited amounts.

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Directors and officers insurance

Provides some protection to directors company and company officers and senior managers, if they are sued as the result of decisions taken whilst governing or managing the business

- Some investors, such as venture capitalists, insist on D&O insurance before providing funds to a company
- D&O insurance should not be confused with E&O errors and omissions liability
- Directors should first look to their company for indemnification
- Directors cannot be indemnified for acts which are contrary to companies' legislation.

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Directors and officers insurance

D&O pays for actual or alleged wrong decisions, ("wrongful acts")

- Policy cover, conditions, and cost/benefit need to be evaluated against perceived risks. The policy needs to cover claims from all possible suitors

- Most D&O policies provide cover against the cost of legal fees and civil damages in defending a claim, subject to limits.

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Directors and officers insurance

- D&O is not available for all who seek it.
- Successful, long-established companies are more likely to be able to obtain cover than companies in riskier situations
- The UK 2003 Higgs report commented that "the cost of D&O insurance is increasing and the coverage appears to be getting less."
- A 2004 report from the Australian Corporations and Markets Advisory Committee noted that: "there is an increasing trend to impose personal liability on directors and other officers for the shortcomings of companies."

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Board information

Regular and routine sources of information

Most boards develop a routine set of board papers

- the latest financial accounts
- cash flow report
- report on operations
- market report
- the CEOs report on significant developments etc.

Some companies have developed computer-based systems for producing routine board papers, and there are proprietary systems.

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Board information

A good report with high quality information is:

- Understandable - at a level of detail, language and content appropriate to the likely readers
- Reliable - the reader must be able to trust that any facts given and any opinions advanced are clearly shown as such
- Relevant - reports need to refer to the matter in hand
- Comprehensive - half of a story, like half-truths, can mislead.
- Concise - directors are inevitably under time constraints
- Timely - directors need reports in sufficient time for them to study the contents, but with material that is up-to-date
- Cost-effective - an aspect of report writing that is often overlooked

With formal board reports there can be a tendency to go on producing standard reports long after their need disappeared.

Board information

Occasional and non-routine sources of information

- In a professionally led board it is recognised that all director information needs cannot met by a standard set of routine board papers. Ad hoc reports and presentations are needed:
  - in-house studies
  - consultants reports
  - investment proposals
  - merger & acquisition proposals
  - market reports
  - technology reports
  - financial studies

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Board information

Informal and unofficial sources

Briefings to the board

Contacts within the company

Questioning in meetings

Discussions with staff

‘Grapevine’ gossip

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Board information

Occasional and non-routine basis

- Contacts outside the company
- ‘off the record’ comments
- Twitter, Facebook and other social media
- Casual reading/TV reports etc
- Unofficial probing and inquiry
- Visits, presentations, conferences

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Board information

Director information systems

- Most board reports still provided on paper
- Secure Internet now emerging as vehicle for director communication

  (iPad, iPhones, tablet computers,,,)
- Programs to present board information electronically

  (Diligent Boardbooks, BoardPad)

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Board information

Issues to be considered with electronic board information

- Confidentiality
- Security
- Integrity
- Availability
- Assurance
- Cost-effectiveness
- Flexibility, simplicity and ease of use

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Board information

Board information audit

- a useful exercise
- confirming adequacy of information for professional board-level discussion of :
  - Strategy formulation including strategic risk
  - Policy making including CSR policies
  - Executive monitoring and supervision
  - Providing accountability to shareholders and other stakeholders.

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Board effectiveness

Board information

The Cadbury Report - "it is for chairmen to make certain that their non-executive directors receive timely, relevant information tailored to their needs, that they are properly briefed on the issues arising at board meetings, and that they make an effective contribution as board members in practice."

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Board effectiveness

Managing meetings, agenda and minutes

- Meetings need planning as well as running
  - why, what, when, where, and who?
- Meetings also need managing and leading
- Meetings of the board and its committees should be learning experiences for all involved.

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Board effectiveness

Managing meetings, agenda and minutes

- Why - the purpose of the meeting, is it necessary?
- What - objectives to be achieved?
- When – date and time?– consider notice and information needed
- Where - location? Board meetings need not be in the boardroom
- who – attendees? Those essential plus others to advise, provide information or observe? Quorum?

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Board effectiveness

Agenda

- The items of business to be covered in a meeting
- Who decides what matters get on the agenda?
- Three approaches to agenda design can be distinguished:
  - The routine approach - meetings follow previous pattern
  - The chairman-led approach, chairman determines the agenda
  - The professional approach - the chairman seeks advice from relevant people and tries to balancing the items and ensuring that adequate time is available.

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Board effectiveness

Minutes

Minutes are the formal record of a meeting.

- Subject to the articles, there are no specific rules governing format
- Companies tend to develop their own style in minute keeping:
  - no more than a staccato record of who attended and what was decided
  - some note the names of the key contributors to the discussion
  - some report of the proceedings verbatim
  - ideally, contain sufficient information to capture the key threads of the discussion, any disclosures of personal interest, the alternatives considered, the agreement reached and plans and responsibilities for action.

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Board effectiveness

Communications – shareholders, stakeholders and society

Corporate transparency is expected by

- Investors
- other stakeholders
- society at large

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Board effectiveness

Communications – shareholders, stakeholders and society

Companies approach to communications vary

- minimum disclosure necessary to satisfy statutory requirements
- statutory requirements plus report of corporate activities and major developments, but no discussion of strategic situation, risk profile, or prospects
- board-level communications policy, differentiates audiences, establishes their interests, determines appropriate content of communications to each, and uses a wide range of different media.

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Board effectiveness

Communications – shareholders, stakeholders and society

Some countries have requirement for major companies to publish commentary of the companies' situation, strategies and prospects.

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Corporate Governance – principles, policies and practices

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