Australian Institute of Company Directors

BOARD

Improving board effectiveness

Board performance is vital to the success of an organisation. To ensure the board is a strategic asset, it must have the right mix of skills and knowledge as well as the ability to work effectively as a team. Today's rapidly changing business environment also requires boards to be flexible and responsive in order to meet unexpected needs and challenges.

Key themes from Deloitte's research report *Courage in the boardroom: Winning in uncertain times*[1] suggests that factors necessary for effective board performance include:

- **Bold, decisive leadership** – It's important to have a strong strategic framework that facilitates better and faster decisions and outcomes. Boards should rely on the right information about strategy, culture, people and customers. This, along with clarity and strong alignment of the organisation's purpose and strategy can cut through the noise and enables decisions.
- **Opportunity mind-set** – Directors need to focus on supporting new opportunities, through meaningful risk appetite statements and clear communication of risk capital and risk pricing, is important. The board needs to be clear on its appetite for innovation and should have realistic expectations for failures that will occur along the way. Its role is to drive a culture that encourages and understands failure as part of the innovation process.
- **Ecosystems are crucial** – Building valuable, open relationships across multiple stakeholder groups is key to building brand trust and organisational resilience.
- **Match fit** – The ability to seize an opportunity depends on how nimble the systems and processes of a business are. Boards have a role to play in challenging the tension of new models challenging existing ones. To do this well, both the board and the organisation need to be agile and open.
- **Culture, culture, culture** – An effective organisational culture is one where responsible risk is encouraged, all employees understand the purpose of the organisation and how their role contributes to meeting this purpose and personal responsibility and openness are encouraged.

1. R Deutsch, 2016, "Seven ways to improve board effectiveness in uncertain times", *The Boardroom Report*, 12 October, **https://aicd.companydirectors.com.au/membership/the-boardroom-report/volume-14-issue-9/7-ways-to-improve-board-effectiveness-in-uncertain-times**, (accessed 8 May 2019).

- **Cracking the diversity code** – Boards must consider dynamic renewal, bringing fresh perspectives and diversity of thinking at a functional as well as cultural level. Directors can accelerate the process of enriching board thinking through gender, educational, cultural, global and experiential diversity.
- **Curiosity is key** – Directors should get out of the 'same old boardroom' and develop new skills and innovation insights. They should task themselves with creating the questioning and challenging environment needed to imagine, inspire and deliver better outcomes. Complacency can be a killer.

Good governance requires that the board monitor the effectiveness of its own performance by regularly reviewing its composition[2], governance relations and internal processes. The are few governance issues more complex than this monitoring, and the symbiotic relationship between organisation, management and board performance makes the measurement of board outcomes more art than science.

Associate Professor Gavin Nicholson of QUT Business School, says an annual board evaluation that has clear goals and is rigorous and challenging remains the best tool to understand, track and enhance board performance over time:[3]

> *In the past, board reviews were mostly about directors commenting on each other, the chair and the overall board. High-functioning boards now seek the view of management on director performance and talk to auditors, key investors or other stakeholders. They are getting input from a wider source of stakeholders to understand board performance.*

How does board composition improve effectiveness?

Size

The size of the board is usually related to the size of the company. A public company will often have between 8-12 directors. Too many directors can be detrimental to boards because discussions become lengthy and it is difficult to get agreement. Large boards can also factionalise, leading to a fracturing of effective and timely decision making by the board.

Balance

Balance means the ratio of executive to non-executive directors and to take into account the independent directors. There is an increasing requirement for independent directors in certain roles, including for example, the audit committee. Generally, it is viewed as best practice to embrace independence based on the view that it leads to increased openness and transparency in decision making processes and therefore produces the desired outcome of enhanced accountability.

Juliet Bourke in *Which Two Heads Are Better Than One?*[4] proposes that balance is framed around disciplined diversity of thinking and the mitigation of inherent biases.

Diversity (including but not limited to age, gender, ethnicity and cultural background) is becoming a more formalised requirement with Recommendation 1.5 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (ASX Principles) suggesting that the listed entity ought to have in place a diversity policy with measurable objectives and disclosure of same. It is important for an entity to determine whether it is a "relevant employer" under the Workplace Gender Equality Act and comply with the legislation.

2. Recommendation 1.6 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, 4th Edition, suggests that a listed entity have and disclose a process for periodic evaluation of the performance of its board, its committees, its individual directors, and, disclose for each reporting period whether a performance evaluation has been undertaken in accordance with that process for the relevant period.
3. T Featherstone, 2018, *Evolving role of board reviews in driving director performance*, Governance Leadership Centre, 20 December, **https://aicd.companydirectors.com.au/advocacy/governance-leadership-centre/governance-driving-performance/evolving-role-of-board-reviews-in-driving-director-performance**, (Accessed 8 May 2019).
4. J Bourke, 2016, *Which Two Heads Are Better Than One? How diverse teams create breakthrough ideas and make smarter decisions*, AICD.

Terms of office

Many company constitutions specify a maximum number of terms per director. While this encourages board renewal, it is important to keep in mind that it may take three to five years for a director to comprehensively learn and observe a reasonably size business.

Board committees

Committees can assist in sharing the board's workload and making more effective use of directors' time. Regular evaluation of a committee's charter will ensure that it is fulfilling its objectives and that the board as a whole is maintaining its overall responsibility for decision making.

How do governance relations improve effectiveness?

The role of the chair

There is a growing emphasis on the responsibilities of the chair. The *Corporations Act 2001* does not specify provisions additional to those for directors regarding the chair, (including any additional responsibilities of other directors). Nonetheless, it has been suggested that the chair occupies a particular role and that in certain circumstances, the carrying out of that role may require the chair to have special responsibilities. Since the *One.Tel* litigation, the idea that the office of chair is procedural and to an extent ceremonial, is somewhat outdated. Therefore, officers assuming the role of chair are advised that there may be circumstances that require them to take on greater responsibilities than their fellow directors.

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The chair's relationship with the CEO

This relationship is critical to the organisation's success and is based on having clearly defined roles and mutual respect. They should complement each other. The chair has a role in the CEO's development, evaluation and in succession planning.

Board and company secretary relations

The company secretary's role[5] has expanded from compliance based to contributing to the board's performance. The secretary is often called upon to advise on governance matters; remuneration; press interests; and other matters affecting the board in addition to their usual role.

Board and management relations

A survey by Nicholas Barnett, CEO of Insync Surveys[6], involved 345 directors who served on 47 boards delivered the following improvement insights on board and management relationships:

- Increase the exposure to line management responsible for specific projects or initiatives without group executive supervision. This provides clearer line of sight to accountability and depth of talent;
- Increase access at board meetings to senior management rather than the CEO only;
- Provide a mid-year opportunity for the board to meet socially with management and staff to give directors a further opportunity to understand cultural effectiveness;
- Support relationships with senior managers so that they understand each other's responsibilities, priorities and needs;
- Foster a *trusted adviser* relationship between the chair and the CEO to support increased alignment of management and board objectives, including increased and regular time together as required.

5. J Robertson, 2018, *The Role of the Company Secretary: Influence, impact and integrity*, AICD.
6. N Barnett, 2012, *Taking your board from good to great: The best 101 ways to improve*, Insync Surveys and Board Benchmarking.

How do internal processes improve effectiveness?

Internal administrative processes are crucial to the smooth running of the board. Inadequate processes can lead to a poor flow of information and ineffective decision making.

Board meetings and papers

Attending meetings and reading board papers are a director's chief source of information and decision making. Receiving well organised papers in a timely manner allows directors to more effectively contribute to board discussions. Successful meetings are well planned and conducted in an orderly manner. The Centro case (*ASIC v Healey* (2011) FCA 717) showed that managing the flow of information for directors is critical. It is important for the board to ensure the volume, content and organisation of board papers sent to directors in advance of a meeting is appropriate; that key matters are highlighted; and, the information is present in the most efficient manner for maximum comprehension. It is equally important for directors to review and feed back into the process of board meetings and papers to ensure that the information sharing key to management decision making is best practice.

Minutes

Minutes are the official records of decision-making processes. There is a tension between the extent that board deliberations are included in minutes and how to maintain a balance between the competing needs for disclosure and for confidentiality when measuring the 'right' amount of content to include in minutes. A minute that is properly signed and recorded will be evidence of the proceeding, resolution or declaration unless the contrary is proven. For this presumption to apply, there must be strict compliance with the one month limit. However, the High Court in the James Hardie case (*ASIC v Hellicar* (2012) HCA 17) emphasised that, even where this formal presumption does not apply, the minutes are nonetheless important evidence because they will be a near contemporaneous record of events. Heydon J in that case concluded that the minutes were 'immensely powerful evidentiary support for ASIC's case'. While the minutes of most companies are not produced as evidence in court cases, it is important for the board to remain aware of their importance and content because, absent legal proceedings, they are an important and useful guide on the governance of the company.

What are some other considerations?

Training and development for directors

The skills needed for boards today are not necessarily those that sufficed in the past. Directors today are increasingly appointed because they possess particular skills and knowledge needed by the organisation. However, the legal and governance environment is constantly changing. The board can assist directors in keeping up to date with trends and changes by providing opportunities for training and development, thus enhancing its intellectual capital. Directors will suggest areas in which they would like to develop but training and development should happen within the context of the board's needs. The Centro case suggests that financial literacy is a necessity and that there is a trend to place more importance on an understanding of information technology.

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Board culture

Cultural issues are as important as structural and procedural issues. A lack of trust, respect and engagement amongst directors can impact on the board's effectiveness. The chair's role is to harness the skills, qualities and resources of the board and to guarantee that issues of personality and style do not interfere with the board's work.

The AICD has published a director tool to help support the board's approach to governing organisational culture.[7]

In *Setting the Tone from the Top*[8], Melinda Muth and Bob Selden examine how director conversations shape organisational culture. The language used in the boardroom can tap the collective knowledge of the board to improve working relationships and collective decision making, and ultimately positively impact the behaviour of management.

What is the role of performance assessment?

In an environment of continuous improvement, the board will monitor and assess progress, identify performance gaps and devise strategies for improving performance. Long term benefits include developing team work, better decision making, improving the effectiveness of meetings and gaining greater clarity of roles. Sound evaluation will include qualitative and quantitative factors.[9]

7. J MacCormick, 2019, *Governing Organisational Culture*, Australian Institute of Company Directors Director Tools, **https://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/director-tools/2019/pdf/governing-culture/07236-3-mem-3-organisation-governing-organisational-culture-july-19-a4-web-v3.ashx**, (accessed 8 August 2019).
8. M Muth and B Selden, 2018, *Setting the Tone from the Top: How director conversations shape culture*, AICD.
9. AICD, *Governance Analysis Tool*, [website], **http://aicd.companydirectors.com.au/advisory/governance-analysis-tool**, (accessed 18 February 2019).

About us

The Australian Institute of Company Directors (AICD) is committed to strengthening society through world-class governance. We aim to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. Our membership includes directors and senior leaders from business, government and the not-for-profit (NFP) sectors.

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