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Getting boards into shipshape

Company boards are no longer the 'buddies' clubs' they used to be. Among the challenges they have to contend with are increasing shareholder activism, hypercritical media, employee distrust, new legislation and consumerism. In today's turbulent environment, shareholders want an effective team of directors that can steer the company into the future.

by Reuel Khoza

With the challenges posed by a dynamic and complex environment, being a company director is no longer plain sailing. Historically, shareholders tended to leave everything to the board of directors, who either delivered or not. But nowadays shareholders and investors are more critical and ask more and more probing questions. So, too, do the hypercritical media – their radar

systems ready to detect any hint of newsworthy corporate moves on the horizon. They flag irregularities, which could lead to a drop in share prices.

Other stakeholder groups are active as well. Employees and organised labour have become powerful constituents that are constantly asking questions of directors. In addition, consumers are more aware of their rights. They have become more sophisticated and demanding, and are increasingly concerned about societal issues and how corporates are perceived to be involved. In response to greater public and media pressure, government continually re-regulates and passes new legislation, which may adversely affect a particular business or industry.

A change of course for boards

The role and emphasis of boards have changed significantly over the years.

Until fairly recently, boards were mostly **ceremonial** bodies – the ‘buddies’ clubs’. The old hands ruled the roost and newcomers found it hard to make their voices heard. Management had it all worked out for the board to rubber-stamp. Board meetings kept to a tight agenda, and very little consultation took place between the CEO and the board beyond board meetings.

Then came the **liberated** boards. In this respect the USA’s Sarbanes-Oxley Act of 2002 – which followed in the wake of corporate scandals like Enron and Tyco International – was a milestone. Boards started to free themselves from CEO and Exco domination. Newer-generation CEOs expected boards to contribute, and directors expected to participate when they accepted their appointments. Furthermore, the capital markets began to price transparency and good corporate governance into their valuation of securities.

The newest phase is the **progressive** board. For such a board, the focus has become enduring company success and how to chart the best course to attain that goal. The horizons have changed to way beyond the present CEO’s reign, or single market and product opportunities. Several characteristics distinguish the spirit of progressive boards:

- Such a board complies meticulously with the law, and even thinks beyond the mere letter of the law.
- The directors gel as a team.
- The directors maintain independence from the company. They have neither worked for the company nor are they

tied to it in a service-level agreement. Even the length of board membership has become a point of consideration in order to maintain objectivity.

- There is a collaborative and constructive working relationship between the board and the CEO. In this relationship, boards will not refrain from confronting issues.
- Directors bring diverse environmental perspectives to the board and they are keen to educate themselves about wider matters in order to improve the scope of their contribution.
- Boards are increasingly becoming a competitive advantage to companies.
- A progressive board is serious about self-evaluation. Ideally, a board needs to be evaluated by an external person because most people tend to do what is *inspected* and not what is *expected*, even on this high level – this is human nature. A good number of boards have progressed to allowing their being evaluated from outside.

A progressive board is serious about self-evaluation

The last point raises several questions. What aspects should be considered in evaluating the performance of a board, and how can it be judged to be effective?

Full speed ahead

Experience has taught that, for a board to be effective, its composition – the so-called hygiene factors – should be considered.

Size matters. The first factor that plays a role in the effectiveness of a board is its size. There is no one-size-fits-all when it comes to boards. They must have enough members to bring the necessary key expertise, such as legal, financial and project management skills to the table, while also taking diversity into account, but at the same time be sleek and agile enough to respond and make decisions.

Board size is also determined by the number of sub-committees needed and the skills required to populate each of these. Banks, for instance, would have more board members because of all the oversight committees required in their business, say between 18 and 20 directors. An ordinary company can have far fewer. If a board gets too big, it could wind up ‘carrying passengers’. For a particular board, therefore, the key to board

size is to find an optimal balance between the important trade-offs.

Independence from management. The independence of a board is the next vital factor that influences effectiveness. It has already been pointed out that progressive boards have a majority of directors that are not connected to the operations of the company. But independence of the board also requires that the positions of CEO and board chair be separated. Of even greater importance is the aspect of independence of mind, with attendant objectivity and strict adherence to fiduciary duty.

Governance factors. While board composition is important, it is not enough. What are the causal factors that will lead to sound governance? There are three main themes of board functioning that should be evaluated, namely:

- The dynamics of the group as a functioning unit

- The architecture of information presented to the board by management
- The focus the board maintains on substantive rather than peripheral issues.

The table on **page 38** provides a sample of questions in each category that should form a basis for board evaluation.

The right chair at the helm

Good governance starts with having the right person chairing the board. The role of the chairperson is not that of a ruler, but of ‘the first among equals’. Chairpersons should set the tone for corporate leadership by ensuring that the board is well run and performs its functions effectively. Ideal chairs keep up effective relationships with key stakeholders, notably the shareholders. In a regulated environment, a sound professional relationship with the regulator is vital. They also concern themselves with corporate sustainability and make sure that succession planning within the company is charted well in advance.

Competent chairs will also run effective meetings that focus on the key issues. Contribution from members is optimised, and diverse and opposing views are welcomed equally. An effective chair will even encourage the less vocal to speak out

Board evaluation		
Group dynamics	Information architecture	Focus on substantive issues
Does the board bring dialogue on vital issues to clear closure, or does it remain fragmented?	Is information presented in a way that leads to useful insights that facilitate productive discussion?	How clear is each director on the strategy going forward?
Do all directors speak their minds freely on key points?	Does the board go out on its own to learn about the company (e.g. by visiting plants) and the industry?	How well has the board bought into the company's strategy?
Do directors respond to each other in meetings, particularly when they disagree? Or do members direct stand-points solely to the chair?	Is sufficient time given for discussion in the boardroom? Or are presentations scripted to the second, with no time left for dialogue?	Has the board discussed with management the potential risks inherent in its strategy? Or has it left risk management to management?
Does the board feel that the company gets a return on the time the board invests in corporate affairs? Or does the board feel its time is not productive?	Does the CEO feel comfortable discussing bad news and uncertainties with the board?	Does the board explicitly monitor financial health and operating performance relative to the competition by focusing on causal factors?
Are the dynamics between the board and the CEO adversarial or constructive?		Has the board discussed succession in depth during recent meetings? Or is it waiting until succession nears?
Do directors individually feel that they get something out of board meetings? Or is attending meetings a chore and a burden?		How familiar is the board with the leadership gene pool and efforts to develop up-and-coming managers?
Have directors acted on feedback that emerged from a real and constructive self-evaluation?		Do all directors fully understand the philosophy underlying their CEO compensation plan?

Questions adapted from the book *Boards that deliver* by Ram Charan (2005)

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and make sure that the board draws on the collective strength of all its directors.

The right chairperson will bridge the gap between the board and management effectively, acting as mentor and coach to both management and the CEO. Meaningful time is spent with the CEO and with reports outside of meetings to ensure that meetings stay focused on strategic issues and do not get bogged down by operational detail.

The chairperson is pivotal in making

sure that the boundaries between the role of management and that of the board are understood and respected without isolating the contribution each party is able to make towards achieving the company's goals.

By submitting themselves to evaluation of their effectiveness as a board and acting on the results in order to improve their performance, directors would be better equipped to steer the company on a course of sustainable success. ■



This is a synopsis of a talk by Prof Reuel Khoza (pmf@akacapital.co.za), professor extraordinaire of the University of Stellenbosch Business School, presented at the Leader's Angle event hosted by the USB, in association with *Finweek*. For more details about the USB's monthly talk series, visit www.usb.ac.za/leadersangle