

COMMON GOALS

An agreement of what needs to be achieved and how is key to responsible governing

In pursuit of effective corporate governance

Getting to the root of some of the problems that beset boards will lead to more rigorous guidance and help achieve better outcomes

From hardly rating a mention 20 or 30 years ago, boards are now newsworthy. Questionable practices and failures of various kinds have seen boards become topical; often targets of criticism in the eyes of the business media, regulators and, increasingly, the wider public.

In addition, the previously little-used term that describes what boards do – corporate

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governance – has become ubiquitous, hackneyed even, to the point now of being invoked as a perpetrator or panacea for all manner of corporate activity, regardless of whether the board is involved or not. Further, many well-intentioned directors do not seem to understand their duties and responsibilities particularly well; they say they have become

confused about the appropriate role of the board, what corporate governance is and how it should be practised.

This article discusses some of the issues boards face as they seek to govern, before suggesting an alternative approach for more effective outcomes.

A challenging context

Modern boards face many challenges and complexities. Seismic geo-political shifts, the rise of populism and the diversity agenda, changing shareholder expectations, and

risks of many types, especially terrorism and cyber risk mean boards cannot take too much for granted in a dynamic marketplace.

Yet guidance to assist boards achieve 'best practice' is not in short supply. In fact, a surfeit of recommendations has now pervaded academies, directors' institutes and boardrooms, some of which have sought to redefine corporate governance. Also, most countries have introduced codes and regulations to both limit malfeasance and provide boundaries and guidance to boards. Among them, a clear separation between the functions of governance and management, diversity of various forms, say-on-pay, and independent directors have been promoted at various times, as precursors to effective board practice. Many boards and shareholders have been enthralled by these recommendations as they have searched for a definitive board configuration to suit their purposes.

But what of their efficacy? Despite the best of intentions, the plethora of recommendations and codes produced to date have yet to have the intended effect. In fact, the seemingly endless stream of corporate failures and significant missteps emanating from boardrooms suggests that contemporary 'best practice' recommendations provide little assurance of board effectiveness, much less company performance. Studies of company and board failures reveal a consistent pattern of contributory factors, including hubris and overconfidence among directors; low levels of board-management transparency; assertive CEOs that 'take over'; lack of a critical attitude, genuine independence, appropriate expertise and relevant knowledge in the boardroom; and, tellingly, low levels of commitment by directors.

It's little wonder regulators are active and public confidence is low. The evidence indicates that corporate governance has entered troubled waters. First-hand observations of boards in action show that the dominant focus is compliance; monitoring historical performance and checking regulatory requirements are satisfied. The protection of professional and personal reputation is clearly a more powerful motivation for many directors than the performance of the company they govern. Something is amiss, clearly.

Focus on what actually matters

In sport, it's well known that rules define boundaries not outcomes and teams that focus on the rules rarely win. The correspondence to boards and governance is direct. 'Best practice' recommendations and codes are, essentially, rules. To focus strongly on them, without also considering the function of boards and behaviours of directors holistically, is short-sighted.

If boards are to become more effective in fulfilling their value-creation mandate,

directors need to focus on what actually matters, especially discovering how best to work together in pursuit of agreed performance outcomes, with the best interests of the company to the fore.

This was made plain recently in an article by Bob Tricker, a doyen of corporate governance. Tricker reminded his audience that the purpose of the board is to govern, which includes overseeing the formulation of strategy and policy, supervision of executive performance and ensuring corporate accountability. Ultimately, the effectiveness of any board in this pursuit is a function of what the board does and how directors behave, not what it looks like. The structure and composition of the board is, in relative terms, less important. Directors take their eyes off this distinction at their peril.

An alternative approach, for more effective contributions

That the ultimate responsibility for company performance lies with the board places it at the epicentre of strategic decision-making and accountability. Consequently, if the board is to have any effect on business performance at all, it needs to maintain an active and sustained involvement in strategic management in some form.

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Some commentators (and many directors and managers) have argued against the board becoming actively involved in strategic management tasks. High levels of involvement are frequently perceived by managers as interference and close involvement can lead to a loss of objectivity in oversight. Yet boards have duties to fulfil. Clearly, if boards are to contribute well, they need to navigate a fine line between detachment, involvement and meddling. For that, trust, cooperation, teamwork, cohesion and consensus-building – both among the directors and with the chief executive – are vital.

Recently published research provides new insights as to how this might be achieved. It demonstrates that if corporate governance is conceptualised as a multi-faceted mechanism that is activated by competent, functional boards, then different (improved) outcomes are possible.¹ The mechanism itself is straightforward: an integrative assembly

comprised of strategic management tasks, relationships and behavioural characteristics of directors (discussed below).

- **Strategic competence:** Directors need to possess competencies and cognitive abilities to exercise sound judgement on specific issues – both individually and as a group. Big-picture, long-term and impartial, inquisitive thinking and a strategic mindset are particularly important if the board is to be strategically capable.
- **Active engagement:** This enables directors to gain insights to make informed decisions, monitor the implementation of prior decisions and the performance of the company effectively and focus on future performance. Indicators include adequate preparation by directors before board meetings; close and supportive interaction between directors during meetings (read teamwork); and an established framework within which to make strategic decisions (an approved long-term strategy).
- **Sense of purpose:** This describes the motivation and resolve of directors to contribute to the work of the board (formulation of strategy, making of strategic and other decisions; monitoring and verification of actual performance; application of controls; and provision of accountability) with the agreed long-term purpose of the company as a guiding principle.
- **Collective efficacy:** The ability of the board to make informed decisions together is an antecedent of effectiveness and performance. A board's performance is the product of not only shared knowledge and skills, but also of cooperation, empathetic interactions between directors, vigorous debate and the situational awareness and emotional intelligence of each director as alternate points of view are explored and debated.
- **Constructive control:** Decisions made by the board in response to various inputs should be consistent with the agreed strategy and long-term goals. The mindset should be that of a coach, providing guidance rather than making punitive responses, the likes of which are more commonly associated with boards seeking to minimise perceived agency problems.

The mechanism-based proposal described here outlines how functional boards can 'perform' corporate governance. In so doing, it marks a return to seminal understandings of shareholder-board-management interaction (the board as a proxy) and corporate governance (the functioning of the board, the means by which companies are directed and controlled) that have been lost among the cacophony of more recent contributions. »

» The harmonious exercise of the five behavioural characteristics within the mechanism provides a platform for directors to interact well and the board to make forward-looking, informed decisions in a timely manner. Unsurprisingly, the core elements are not dissimilar to the antecedents of effective teamwork (compelling direction, enabling structure and supportive context) and integrative models of mission achievement (purpose, strategy, values and behaviour standards) described elsewhere. It follows directly that effective corporate governance is a product of meaningful teamwork, synergistic interactions and a commitment to action among competent, functional directors acting with an agreed strategy and the long-term best interests of the company in mind.

Implications for boards

The concept of corporate governance is both straightforward and stable (the root word is *kybernetes*, meaning to steer, to guide, to pilot). In contrast, the practice of governance (i.e. what boards do and how directors behave) is inherently complex and quite dynamic – even more so when the incessant march of new ideas and technologies, and the miscreant motivations of some directors are considered.

A mechanism-based understanding of corporate governance provides an alternative pathway to achieve more effective outcomes from those promoted by conventional wisdom. Specifically, it provides an integrative framework; outlining the tasks, interactions and behavioural characteristics that are conducive to effective contributions. However, it also challenges orthodoxy by setting structure and composition recommendations and

constraints to one side, as well as any notional physical or task separation between the board and management.

The close working proximity of the board and management that is a feature of this proposal is not without its challenges. Complex group dynamics and the inherent difficulty of separating shareholder, board and manager roles (especially in smaller shareholder-managed businesses or boards with so-called executive directors) can have a negative impact on decision-making objectivity in particular.

Similarly, the temptation to embrace operational detail inadvertently confuses the roles of the board (corporate governance) and managers (business operations, including strategy implementation) and shorten the view remain very real challenges for directors around the world – especially in times of crisis or disruption. If boards are to fulfil their governance responsibilities well, a clear sense of purpose supported by a coherent strategy and a well-defined division of labour is essential – regardless of the company's size, sector or span of operations.

Early agreement on terminology, culture, the purpose of the company and the board's role in achieving the agreed purpose provides boards with a much-needed foundation upon which to assess options, make strategic decisions and, ultimately, pursue high levels of performance. Increasing numbers of boards are starting to realise that material benefits are available if they take these steps.

More generally, directors need to ensure that they thoroughly understand both the

business they are charged with directing and the wider operational and strategic context within which the company operates, so their contributions in the boardroom are both contextually relevant and effective. A programme of continuous learning and discovery is recommended. Although not yet commonplace, increasing numbers of directors are now reportedly allocating as

many as five hours outside the boardroom for every hour in board meetings. In addition to reading and understanding board papers, these directors say they read widely about emerging ideas, trends, technologies and practices to ensure a sufficiency of knowledge about both the practice of governance and the market/sector the company they govern operates in, as well as the new opportunities it offers.

In the end, boards should hold tight to their core responsibility, which is to govern in accordance with both prescribed duties and the long-term purpose of the company in mind. Necessarily, effective steerage and guidance requires the board to be discerning and committed to the task at hand, using reliable governance practices in pursuit of better outcomes, lest they be diverted by spurious (and often discordant) recommendations that appeal to symptoms or populist ideals. The mechanism-based proposal introduced here provides a useful option for boards to consider as they strive to realise the full potential of the companies they govern. 🌐

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¹Doctoral research conducted by the author, a long-term study of boards in action.



ADOPTING THE RIGHT APPROACH
Companies need to reassess what corporate governance actually is