

**DEVONSHIRE HOUSE NETWORK – DIRECTOR FORUM CORPORATE GOVERNANCE ROUNDTABLE**

**Hosted by CRS at 16.30pm on 13 FEBRUARY 2018**

**BETTER BOARD DECISIONS - Removing the Obstacles to Effectiveness**

**Minutes of a discussion under Chatham House Rule**

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The format of the roundtable was to define the focus and address six specific key themes.

Clarity was given on what was not part of this debate:-

- (i) directors' duties – a given in the context of the debate
- (ii) nor the key principles of public life,
- (iii) nor the detail of how Board papers should be presented,
- (iv) or the structure of agenda,
- (v) or the cornerstones of good governance.

The focus of discussion would be on the “People Factors”, the undiscussed issues and factors that inhibit the Board from effectively focusing on its collective role.

**1. Nightmares – Money, People & Behaviours**

Money is a key executive driver. NEDs by contrast earn little relative to the time and effort but particularly relative to the risk burden. The media is peppered with examples of greed and unilateral decision making which is why non-executive independence and the manner in which they interact are both vital.

An independent Remco is essential, one without the presence of vested interests. It is best practice that the Chairman and CEO are not members and should not be present other than by invitation for a specific matter. Equally, the quality of the Remco Chairman is vital as this Committee is the pivotal point for taking on some of the most difficult topics, to debate and process them seamlessly engendering good reception.

‘Governance maturity’ enables a Board to hold a mirror to itself and encourages self assessment in terms of how each contributes and their impact on others. EQ and IQ are thus desirable ingredients to balance relationship building and getting the job done.

People and their behaviours make or break the ability to follow a process to enable good decisions. Cliques can be damaging, as are territorial posturing and arrogance.

Relationships between Directors with different strengths and skills, and between the various key players – CEO and Chairman; Co Sec and SID; NEDs and executives are vital. The ability to have the right conversations (and to hold difficult conversations) is underpinned by transparency and courage particularly when issues of ‘fit’, undesirable behaviours or underperformance need to be addressed.

The value or destruction of having pre-discussions with other Directors before a matter is debated by the Board. is this divisive or helpful? This will depend on Board relationships and whether there is any intention to undermine a decision or an individual associated with it.

Transparency is critical, and one could argue that the more a matter is discussed, the better the quality of discussions therefore decisions should not be pre-made. Those with entrenched views need time and reflection to consider the issues. The Chairman's job is to spot issues and to try to address them in advance, preparing the ground and the people for decision making requires good leadership and understanding; IQ and EQ both being key elements here.

## **2. Relationships and Roles – moving towards effectiveness**

The quality of the Chairman is key; using one's power to leverage an agenda item or taking a competitive stance doesn't bode for good decision making. It's a lonely role which needs a critical friend who can be turned to for seeking opinions or surfacing worries can provide support. This is usually the SID. While the SID has a key role in being accountable to shareholders and in maintaining complete independence always addressing the fiduciary duty first and supporting the Chairman, while maintaining proper distance, is a necessary function. The SID needs self-discipline and experience to carry out their role effectively.

(The same is true for CEOs, who are also likely to be in need of an independent confidante.)

For the Chairman, the only path going forward slopes South (there is no higher position). They should make the difficult decisions and the collective Board should aim to empower the Chairman to be the best possible at executing his or her role.

The need for EQ, social intelligence, applying empathy and engaging the people skills, the ability to work through challenges screams out as a key missing Board ingredient, still today. Although these skills may not naturally reside in the Chairman, the CoSec and the SID should exercise EQ, to support the Chairman in a constructive manner to be their best, both in governance and leadership.

IQ is taken as given. the technical, legacy and regulatory awareness which drives the business has its home in all executive and non-Executive Directors.

The Genius Ellipse demonstrates key Board relationships:

- CEO and Chairman, where a successful relationship demands the requirement for EQ and mutual respect. If the CEO's view of the Board is negative, this will permeate into the executive team – thus creating barriers. It then limits the ability of the NEDs to act as sounding Boards to the executive and can restrict their ability to access staff and information.
- SID and CoSec, the governance, IQ and EQ pillars are the second level contact point for stakeholders;
- Executives and NEDs where reciprocal attitudes, the manner and tone of challenge and support relationships underpin the Board's relationship with the CEO and senior executives.

A coaching attitude or approach can provide the answer to enabling constructive relationships. Boards need to be alert to signs that information is being hidden or key decisions taken without their approval.

Trust is vital for relationships to thrive!

The Board's purpose and aim should be the success of the company which is central to Directors' fiduciary duties. An example was given where a crisis transformed a Board with a resulting move to greater transparency, independence of mind and a collegiate, values-based approach which then delivered clarity of understanding of the Board's role on an individual and collective basis. In this example, the removal of barriers in relationships and the stance taken to decision making occurred to enable effective working together. Transition can be painful, resulting in the loss of individuals who cannot adapt which is ultimately the best for the business.

Often, the refusal, or lack of courage to take decisive actions (in relation to individuals who are non-performing) can only come as a result of a third party "intervention". This allows for denial to be replaced by realisation unless the Chairman simply cannot face up to the issues or take the right path. In which case, there is a job to be done by the non-executives and worst case, the key shareholders.

There was a view expressed, however, that the Chairman has a responsibility to have the difficult conversations around performance, and accordingly it is indefensible to rely on a third party to do this for them. This was contra'd by the recognition that many Chairmen do literally avoid the difficult people conversations and often for very unexpected personal reasons.

However, board evaluations have a value in that they are broader and objective in nature and provide the opportunity for all members to speak confidentially to an independent expert who will feed back the collective messages and recommendations appropriately. Confidentiality being the hallmark of the process. Sharon spoke authoritatively in relation to her experience in conducting Board Evaluations and noted that the process will bring a series of recommendations that will improve Board effectiveness comprehensively, together being a powerful drive for change, rather than solely focussing on particular individuals or one condition.

### **3. Boards as Disrupters – Are we too formal and polite to engender change?**

Boards need to challenge – fact! Being too polite or being reluctant to have conversations are tantamount to ineffectiveness and lack of complete and rounded debate, thus the risk of bad or non-decision decisions being made.

This is an example of an "Elephant in the room", the one conversation the Board does not have or worse does not even recognise it exists. Does the Board or more specifically, does the Chairman recognise this unspoken barrier to its full effectiveness or does it need a third to point out the phenomenon?

In managing a diverse set of individuals, if the Chairman's EQ is low and they are not sensitised, then the risks to the company are high that the barrier to effectiveness is not addressed for a very long time.

If the Chairman fails to be responsive, or cannot deal with a situation, particularly where there is a lack of information provided to the Board or where relationships break down, then another solution needs to emerge. Chairmen need to move on if they cannot exercise leadership of the Board or work constructively with the CEO. Collective action by the NEDs may be an action of last resort, but a necessary one if the Chairman cannot respond to, or resolve, their personal shortcomings.

However, there is much in-between; dealing with executives who want an outcome which does not find favour with the Board is a difficult issue. NEDs need to work collectively with the Chairman to achieve a solution so understanding the executive motivations and fully understanding their own reasons for concern or resistance to executive proposals is part of the learning and determination of what is best for the organisation.

If key relationship issues are not addressed, they potentially become toxic and fuelled by personal agendas and power struggles.

Standing your ground on a strong belief or principle is the right thing to do. But there are ways of playing the Board room “way it is done here”. Being argumentative or challenging relentlessly on every issue is not construction.

NEDs personify a brand and their reputations are at risk so in their best interests, asking the right questions in the right way to support the best actions or decisions is a pre-requisite.

Sharon gave an example of her resignation as a CEO in the face of the Board’s desire to change the business model such that the customer was directly negatively impacted. Had she stayed and implemented the board’s majority vote, the customer would have been impacted and her reputation would have been destroyed.

A strong moral compass is needed for Directors to guide achieving the right decisions. Recognising first instincts is powerful as they are normally right, in terms of sensing and then unearthing problems within organisations.

Is Disruption the paradox of Destruction? Or can disruption be viewed positively? Boards are not perfect and not all relationships are perfect – but the key relationships noted above and in the Genius Ellipse need to be worked on to achieve a maturity of approach and to develop understanding of the behavioural traits of others.

Culture is a significant issue; the example of the Board’s behaviour permeates into the organisation. Good leaders understand the people they deal with – consequently, negative and people induced disruption is reduced.

Is a degree of disruption necessary when key issues are at stake? Not to be confused with dysfunction - a term used too readily for a raft of situations - dubiously, when outcomes do not suit other, or interested, parties. Positive disruption is not likely to occur where a Board populated with inhibitions, Directors who fails to challenge, collectively provide weak participation or there is poor leadership.

#### **4. It's Tough at the Top – especially if you are reviewed**

A Board Evaluation focuses on recommendations for change delivered to the Chairman and the Board and if embraced and well used are an ideal independent catalyst for change.

Reflection and understanding 'the image in the mirror' is a process. Giving feedback aims to unravel the issues that concern Directors, executives and key stakeholders. Implementing the changes arising from an evaluation demands a good dose of EQ. The SID and CoSec are key players in the process.

However, the fact that the Board positively engages with third party input is often a self-risk or culture barrier. Why would a Chairman want such a procedure that risks disrupting the status quo on their watch? If so persuaded to engage in the exercise, are they willing to open their minds and take the advice offered? Where do the issues actually lie, and are there solutions to be found in Board development and relationship building? How far can change be enacted?

It is vital that the process of feedback is founded on anonymity otherwise there is no safe environment to develop trust. Boards need to be clear about how the process is delivered and what information each group might be privy to.

Feedback can be difficult, particularly if there is an issue around the Chairman's role. A point was made in that, as good practise becomes a feature of Board repertoire such as a frank discussion following a meeting on 'how did it go' and 'what can we improve', there will be more cohesion and collective responsibility that will enable change to occur.

Creating a safe space for giving feedback is essential for the evaluator and the Chairman, using sensitivity and diplomacy to underpin the communication of difficult messages without short changing the message. There are myriad examples where, for example, a Chairman is insufficiently authoritative; is too ingrained in the business; is too cosy with the CEO; is unable to address relationships or dissent in the Board.

Small companies are more likely to develop 'cosy relationships' at the top meaning that the Chairmen are not playing out their role nor effectively leading the Board.

Directors who constantly seek self validation become wearing. This often occurs where a particular Director has a specific focus or expertise and homes in constantly on this topic whilst not participating competently in all matters of the Board. A good Chairman will manage such Directors ensuring that the right air time is given to the subject and the Director is coached and encouraged to contribute on all topics. If this is not properly managed it drains the energy of a Board delivering very quickly ineffective engagement and relationships.

Key questions for Chairmen were felt to be 'what is your purpose and what do you want to achieve'. Clearly, there are different styles of leadership – but is the Chairman conducting an Orchestra or a Jazz Band? Does the Chairman recognise that as a conductor of the Orchestra, the baton in his hand is not a musical instrument? The Chairman guides and choreographs, the Chairman does not lead all conversations or make the decisions; that is the role of the lead guitarist of an orchestra – the CEO of the organisation.

Encouraging openness and involvement is key and playing on members' different qualities and skills is the role of the conductor Chairman. It takes time to know Directors and stakeholders and to understand what / how they can contribute in terms of their technical capabilities and in other dimensions of their experience and their approach.

Diversity means combining different skills, knowledge, backgrounds, experiences, approaches and styles to deliver a multi-faceted dimension on key subjects which is important to support effective Board leadership for the executive team. Having diversity for its sake, quotas, will make it difficult to build a cohesive respected team.

## **5. Transparency – all the time, no matter what**

Trust is vital in all aspects of the Board's and the organisation's activities.

How do the Chairman and board Directors really know what is happening in the company? How do the NEDs know given that they have to remain non-executive – noses in but fingers out?

Misunderstandings, lack of knowledge and own assumptions lead to errors which can compound or disguise issues.

Ability, mutual respect, genuine curiosity whilst having ability to be supportive underpin a powerful NED relationship with the executive. The NEDs need to be convinced or persuaded of the benefits of a particular issue, the executives being fully open and articulate while the NEDs remain focused on the rights points of importance which together they will generate a confidence and value in placing matters before the Board.

Transparency is paramount. Getting the Board 'into' truly understanding the organisation can be difficult, often impossible. Two factors are at play from the Board side, they are non-executive and need to remain independent and from an engagement point of view, they are involved for only 30 or so days a month, not every day.

Executives putting up a barrier to information flow, engagement, involvement or understanding is totally unacceptable! A culture of not seeing the Board as integral and part of the organisational "team" results in flawed outcomes and ineffective leadership.

Directors absolutely need to have a good feel for what is happening in the business so that as an effective leadership vehicle, the Board delivers a culture of continuous development.

Engineering change should not take a crisis to force the Chairman and the Board to address their responsibilities.

Transparency is the provision of the right information to keep the Board fully informed; engagement by the Board in understanding the goals and steps required to achieve these visions, together deliver a mutual respect and forum for adding value through debate and effective decision making. What is not to be forgotten, the Executives on the Board are Directors in all aspects of responsibility, equal to that of the NEDs, there is no place for "us and them"

It was suggested that having the right KPIs and MI are key and discussion with the executive on the data that is presented to the Board should occur as a matter of course; do the metrics and information put forward match the Board's requirements? It was noted also that focus on inputs, as much as outputs, is needed.

The FRC has issued a Consultation Paper suggesting three ways to bring the employee stakeholder voice to the boardroom:

- Electing an employee onto the Board as a Director. A person who can step up to the role and responsibility;
- Defining a NED to specifically represent employees on the Board;
- Establishing an employee forum that reports into the Board.

Positive examples of engagement were of student and staff representation on a University's Board, charities which have "recipients" present at Board meetings and NHS Trusts which include patient representation.

The counter concerns were the openness of conversation, key matters being discussed outside the Boardroom, the awkward position of having information while having to remain integrated in their own teams, dumbing down the conversation, having a non-contributing Director who is unable to perform their fiduciary duty and being singularly focused and not strategic.

Guidance to encourage transparency, in the shape of information flow, should be developed in discussion between the Board and the executive. Executives should be open about what a NED should know to be of value. Executives should challenge ned on what they want to know, and why and what will they do with the information received.

NEDs should have walkabout and engagement days where they spend time in meetings, in the business, on the shop floor, with customers or the regulator etc. Seeing and understanding in various areas by various directors brings a colour and dimension to the discussion beyond the papers allowing the surfacing of issues and discussions that are real and valuable as insights are true not guessed.

A Board's agenda needs to shift to focus more on strategic direction, risk and decision making rather than on governance, process and review of what has happened.

## **6. Handling Non-Performing NEDs**

Where might the issues lie? NEDs:

- Competent, thought to be the font of knowledge – but generally not engaged;
- May lack diversity of thought – and cannot think independently;
- Territory and importance – engaging in the political human games of self-promotion;
- Prickly and defensive, self-protecting, self-interest, not embracing the collective.

However, diversity comes in all shapes and sizes: some NEDs may be 'quiet' but will cogently put across points when the need arises, with perspicuity, in their own areas of expertise – the key is to

ensure that in other areas of debate, they challenge sufficiently. On the other end of the scale, Directors can be vocal, unstructured and deflecting.

The Chairman needs to act on poor performance otherwise ineffective outcomes manifest very quickly.

Actions could include training, coaching, changed engagement with the organisation and if all else fails - ultimately the NED leaving the Board. The Nominations Committee should be pivotal in ensuring that Directors deliver value.

However, as seen earlier, not all Chairmen will address the difficult issues.

There is also the issue of 'self preservation' by NEDs, but which applies equally to a Chairman – who may act tactically via 'divide and rule', or react emotionally to a problem, take too long to address issues or blatantly ignore key "elephants".

The expectations and terms of the NED's role need to be clearly stated – they should be encouraged to have a voice – but if they cannot accept the terms of the role, or work within the culture, they need to recognise the lack of fit. It is unethical to act otherwise.

The appointments process for NEDs, is a lighter touch to recruitment a better option than a full appointment process? Does the approach depend on the nature and size of the organisation? Care is necessary to appoint the right people as NEDs can cause chaos if there is no "fit". Careful, aligned and objective selection is critical given their position of authority.

### **Concluding Thoughts**

- Be prepared to change roles or people when necessary to enable the Board to function effectively;
- The right person as the Chairman's is key with a balance of EQ and IQ, who engenders respect and delivers leadership otherwise the Board will lapse into degrees of ineffectiveness.