Part 3

Practices

10 The Reality of the Boardroom

- In which we consider:
  - how people, power, and politics affect practice
  - sources of governance power
  - games directors play and the manipulation of meetings
  - board styles
  - the significance of the chairman
  - implementing corporate governance below board level

In the first two sections of this book we have focused on the underlying principles and policies of corporate governance. We turn now to the realities of the boardroom. In the third and final part of the book we look at the practices of corporate governance.

How People, Power, and Politics Affect Practice

Until they have served on a board, people may well imagine that directors behave rationally, that board level discussions are analytical, and that decisions are reached after a careful consideration of alternatives. Not often. Experience of board meetings, or of the activities of any governing body for that matter, shows that reality can be quite different. Directors' behaviour is influenced by interpersonal relationships, by perceptions of position and prestige, and by the processes of power. Board and committee meetings involve a political process. In fact, corporate governance is more about human behaviour than about structures and strictures, rules and regulations. Corporate governance involves the use of power. It is a political process.

The standing and prestige of board members does not guarantee a successful board. Members of Enron's audit committee included one of the best known American accounting academics, as well as a member of the British House of Lords and chairman of the UK Press Complaints Council.

In board activities much depends on board leadership and the way the directors work together. Sound boards have sound leaders. Good leaders create successful teams. It has been said that '*outside directors never know enough about the business to be useful and inside directors always know too much to be independent*'. Successful boards avoid this claim, with all directors, both executive and non-executive, forming a cohesive team in which

independent, tough-minded individuals work together, with trust and mutual understanding, to achieve common goals.

By contrast, poorly performing boards are likely to have weak leadership and members with little commitment, focus, or time. Some directors may lack interest or, worse, be motivated by self-interest; others may be complacent, arrogant, or dominating, some may be easily led or weak-willed failing to speak out when disagreeing with a board decision, and a few may be incompetent. We will consider the experience, skills, and knowledge that make for a successful director in the next chapter.

Sources of Governance Power

As we have seen, corporate governance can be thought of as the way power is exercised over corporate entities. The issue now is how that power is derived, who wields it, and how it is used. What is power? Mary Parker Follet's definition will serve us well: '*power is the ability to make things happen*'.

The fundamental legal power of the board derives from the members who have delegated the running of the company to their directors. This power is reinforced by authority derived from the company's constitution backed up by company law. However, a board can also find itself influenced in a number of ways, for example:

- By a dominant shareholder or group of shareholders putting pressure on the board. For example, the board of a wholly owned subsidiary company must conform to the business policies, plans, and investment decisions made by the group holding company
- From the threat of a potential takeover. In a public company quoted on a liquid financial market the ambitions of predators through the market for corporate control can be a constant source of power over a board's behaviour
- By the prospect of litigation. In today's litigious climate the threat of significant law suits from customers (e.g. claiming damages for faulty product or service), from employees (e.g. suing for damages from heath hazards), or competitors (e.g. alleging infringement of patents or copyright), can concentrate a board's collective mind
- Through the influence of the auditors. An independent external auditor's threat to qualify the audit report, unless significant changes are made to the declared profit, perhaps because of disputed asset valuations, backdated share options, or unrecorded exposure to risk, is likely to affect a board's deliberations
- From the effects of legislation and regulation. The prospect of new rules regulating the way the company does its business (immigration controls on employees, tariff barriers, corporation tax changes, for example) are bound to influence a board's deliberations
- From media pressure and other external exhortation. Recent years have seen a significant increase in the interest an investigative media has in companies; and external lobbyists, interests groups, and institutional investors may all seek to exert power over a board's thinking
- From the risk of damage to personal reputations. Directors' decisions can be affected by individual directors' concerns about their exposure to risk, both financial and reputational

- By a dominant or charismatic leader. As we will see later, the effect of the chairman, chief executive, or other board member exerting leadership can have dramatic effects on other members and on the way the board acts, and, obviously
- Through changing business circumstances

How a board handles these potential influences is a mark of its professionalism. But in addition to external sources exerting power over a company and the decisions of its board, individual directors can also wield personal power over board matters.

The power of individual directors also derives from a variety of sources, for example:

- Personality power, in other words the power wielded by a charismatic or a dominant individual over other members of the board
- Knowledge power, that is the power derived from access to information, skills, or experiences not available to the other directors. For example, the influence that an INED, who is also a director of an international bank, has when the board is discussing the effect changes in currency rates might have on the company's finances
- Sanction power, which is the power that exists if a director can apply some sanction to the company or to other directors. For example, in a joint venture company the possibility of one partner removing access to an essential source of supply, or in a family company the threat of the parent to cut his or her child from the parent's will
- Political power, that is the ability of directors to play boardroom games, which we will briefly consider in the next section
- Interpersonal power that one person might have over another because of their relationship, for example where a father and son serve on the same board, or private knowledge that one director has about another
- Organizational power derived from position in the organizational hierarchy. For example, a CEO inevitably has potential power over other executive directors because managerially they work for him or her and their prospects depend on that relationship
- Networking power derived from contacts and acquaintances of value to the company and useful in board decisions. This power is captured in the well known phrase: '*it's not what you know but who you know that matters in this world*'.
- Societal power derived from a position of influence in society. A well respected and connected member of society may be able to influence decisions to the company's benefit and public opinion about company activities. That is why retiring politicians are offered board positions, and why 'cooling-off' periods are written into their contracts.
- Ownership power and the ability to determine board membership. A director who is also either the majority shareholder in a company or his or her nominee has undoubted influence on board deliberations, even though the right to hire or fire other directors may seldom be mentioned
- Representative power delegated from an external power source such as an institutional investor, a joint venture partner, or in a not-for-profit entity the members

Games Directors Play and the Manipulation of Meetings

Board level processes, the conduct of meetings, and interactions between directors, above all, involve communication. Deconstructing directors' comments, mainly spoken but sometimes written, can identify many layers of underlying meaning. What a director says, and even more significantly what he or she chooses not to say, can demonstrate his or her understanding of and involvement in a topic under discussion. At a higher level of abstraction it can illustrate his or her views on that subject. But it may also illuminate his or her personal beliefs and values, opinions of other members of the board, and sensitivity to what other people are feeling.

In board level dialogue, the manner and form of communication is significant. Many board members are powerful people, with high self-esteem, and big egos. Some are arrogant, self-opinionated, or boastful—a few may be bullies. But others can be diffident, insecure, and shy. Being a good listener is a hallmark of an effective director. Sensitivity to the views of colleagues, hearing not only what they say but deducing why they are saying it creates a climate of mutual trust.

Of course, being a good advocate for an issue under discussion, being able to advance a case clearly, concisely, and with conviction is also an important attribute. So is the ability to debate contentious issues, in which others hold contrary views. The effective director is aware that if a person's proposals are rudely attacked he or she is more likely to counterattack than have a change of mind. Politeness has its place in the boardroom.

In badly led boards, personalities and political manoeuvring can prevail and directors will play games. An awareness of some of these games can help create a board culture in which they become apparent and are stopped. In a light-hearted review, here are a few of the games directors play.

Alliances

Two or more members of the board conspire together to influence a board decision. For example, two executive directors, each responsible for an operating division in a group, work together to prevent the introduction of a proposed management control system that would result in greater transparency of their divisional activities: however, they both agree to argue their case on the grounds that the system would prove expensive and that cost would outweigh any benefit.

Coalitions and Cabals

Groups of directors work together, inside and outside the boardroom, to bring about a specific outcome to a board decision. Coalition building involves the canvassing of support for an issue informally outside the boardroom so that there is a sufficient consensus when the matter is discussed formally in the boardroom. For example, a group of directors in a not-for-profit company incorporated to run a sports facility opposed plans to build a new swimming pool. The members of this clique were all non-swimmers, and refused to sanction other expenditure unless the swimming pool plan was dropped.

Cronyism

Relationships between directors can influence decisions on the basis of personal relationships not the rational merits of the case. Cronyism can produce decisions that are not in the best interest of the company. For example, three directors on the board of a listed company were all members of the same country club. They tended to support each other in board discussions, all favouring the same outcome and opposing the same alternatives. Cronyism can affect an entire board. For example, a director declared a personal interest in a tender for a project being discussed by the board. He was asked to leave the room during the discussion of that contract. But the board decided to support this bid because of their personal relationships with that director, even though the bid was not the most worthy.

Deal Making

Agreements made outside the boardroom between two or more directors to achieve a specific outcome on a board issue. Deal making is a classic game, usually involving compromise. The medical members of a hospital board agreed, during a private dinner, to put pressure on the board to acquire some new sophisticated medical equipment they wanted. They were successful, even though there were more pressing needs for the available funds, including cleaning equipment for the wards.

Divide and Rule

When a contentious issue is being discussed, the outcome wanted by one faction is more likely to be achieved if the other directors can be divided into a number of disagreeing factions. This is a ploy adopted from the chair in some boards. Divide and rule can be a dirty game, in which the player sees the chance to set one director against another, or groups of directors against each other. An issue in the financial accounts might be used, for example, to divide the executive directors, the non-executive directors, and the auditors from each other, in order to achieve an entirely different personal aim. For example, a senior INED serving on the board of a Canadian cooperative advanced arguments that divided the board into three groups reflecting the views of the various representative groups—suppliers, customers, and the administration—thus he could push through the strategy he wanted.

Empire Building

Usually adopted by executive directors, empire building involves the misuse of privileged access to information, people, or other resources to acquire power over organizational territory. The process can involve intrigue, battles, and conquests. Take the example of a company in the IT consulting business, which acquired a marketing company to promote its business. The operations director of the IT company moved his staff to the more palatial offices of the marketing company, took over its fleet of cars, and argued in the board meeting that his deputy should also become a board member, because of his enlarged portfolio of responsibilities.

Half Truths

By presenting only part of the information on an issue before the board, an unscrupulous director can bias the discussion in favour of his or her own preferred result. Whilst the director does not actually lie, the half truth obscures the full story. For example, an executive director argued strongly in favour of his own project, presenting impressive cost/benefit information in support, but failing totally to mention that the risk of stoppage to the firm's entire operation would be significantly increased.

Hidden Agendas

An individual director offers a convincing argument in support of a particular line in a board discussion without adding that additional outcomes to his or her advantage would then arise—the hidden agenda. Hidden agendas usually involve the pursuit of secret goals that benefit a director's own interests or further his or her own career against the interest of the organization as a whole. In other words, the ploy is another example of the agency dilemma. For example, in advocating a contract to acquire services for a joint venture, a director on the joint venture company board failed to mention that this contract would bring significant sales discounts on products bought by one of the joint venture partners—his employer.

Lobbying

Lobbying involves attempts to influence directors, or those in a position to influence directors, usually outside the boardroom. Consider the implications when a director of a consulting practice sought out the wife of the CEO of a client company during a cocktail party and encouraged her to persuade her husband to accept a quotation.

Log Rolling

Two or more directors colluding, to their mutual benefit, is a classic board level game. For example two executive directors in a manufacturing company came to an agreement before the board meeting. The first would enthusiastically support an investment proposal benefiting the second, whilst the second would offer mitigating arguments during the review of the poor budgetary performance of the first.

Propaganda

Propaganda is the dissemination of information to support a cause, without attempting to show the complete picture. The chief executive of a finance institution made a PowerPoint presentation to his board, advocating the introduction of a new derivative-based product, without once mentioning the word 'risk'. Unfortunately, none of the non-executive directors raised the question, the board approved the proposal, and a year later the company had to issue a profit warning following losses on the new product.

Rival Camps

Rival camps is an extreme case of coalitions and cabals, where there are opposing factions on a board. Hostilities, spies, and double agents can be involved. The board of a *Fortune* 500 company were totally split on a proposal led by the chairman/CEO's proposal to bid for a rival company. Leaders of each faction emerged and the two groups began to hold separate meetings, to brief the press independently, and to talk with institutional investors about their own perspectives on the bid.

Scaremongering

Scaremongering is used by some directors to emphasize the downside risks in a board decision, casting doubts on the situation without presenting a balanced perspective, thus attempting to have the proposal turned down. As a director in a multinational manufacturing group argued convincingly, when the board were considering building a new manufacturing facility in another country, '*we shall have nothing but labour troubles, high taxes, if we locate there, and possibly government interference . . . and who knows what might happen if the present government falls? We could find all our assets nationalized without recompense.*' A risk assessment would have shown the probability of these future uncertain events to be low.

Snowing

Snowing involves deluging any director who asks for more information on a topic with masses of data, thus confusing the situation and hiding any cracks. This game is usually played by executive directors on unsuspecting outside directors.

Spinning

Spinning, a form of gaming developed at governmental level, intentionally presents a distorted view of a person or a situation, in a way that favours the spinner's interests. In corporate governance, spinning can be carried out at the level of board committees, the board as a whole, the shareholders, or the media.

Sponsorship

Sponsorship is support by a powerful director for another director, often a newly elected director, usually for their joint benefit. For example, the long-serving director of the Australian subsidiary of an American global group commented during a board meeting '*Mr. Chairman, I'll have a word with Robert (a new director) after the meeting to explain how we handle these things. As you know I've a lot of experience of this type of situation and what we've done in the past.*' In the ensuing discussion the experienced director relayed a lot of gossip about the ways of the board and its chairman to his own future benefit.

Sub-optimization

Sub-optimization occurs when a director supports a part of the organization to the detriment of the company as a whole. We have explored this situation already, both when considering the agency dilemma and in group management control systems.

Some executive directors suffer from tunnel vision, because they are too closely involved with a functional department, division, or subsidiary company. Others may have a myopic view of the situation because they would be personally affected by the outcome. An independent evaluation of the overall strategic situation and top management performance by outside directors can help to overcome such problems.

Window Dressing

Window dressing includes making a fine external show of sound corporate governance principles and practice, whist minimizing failures. Some companies' mission statements, social responsibility and sustainable reports, and core principles suffer from window dressing. Window dressing can also involve showing financial results in the best possible light, whilst hiding weaknesses, although this runs the risk of an adverse audit report or worse.

One of the problems facing companies publishing non-financial statements to shareholders, such as those required in an operating review, can give rise to concerns about window dressing. Information about strategic intentions is open to optimistic presentation and is not amenable to conventional audit. Contrariwise, few boards are likely to expose their shareholders to information about potential risks facing the company from competitors, predators, or other uncertain future events.

Notice that most of the 'games' described involve the subtleties of communication and interpersonal relations. Most of the tactics are not illegal, do not amount to fraud, nor are they inherently dishonest. They are a means to achieving directors' personal preferences. Notice, too, that many of these 'games' are commonplace in the world of government, where they are considered legitimate. Indeed in some boards, too, game playing becomes an art form and board meetings more like the deliberations of an adversarial parliament. Strong chairmanship can reduce the disadvantages of game playing, unless of course the chairman is also playing games! The ideal is a well led professional board team working together with integrity, where directors understand and trust each other, and therefore do not need to resort to game playing.

Before leaving the topic of board level politics, here are a few more light-hearted thoughts on the board level game of manipulating meetings.

Meeting Manipulation

There are a number of devices that directors have been known to use to achieve the results they want in meetings. These include:

- *Management of the agenda* which determines what is and is not discussed. Influencing the agenda is a powerful weapon and experienced chairmen will ensure that they remain in control

- *Challenging the minutes* of the last meeting at the start of the next meeting. This device can be used to re-open discussion of an item that was resolved, against the manipulator's interests, previously. Strong chairmanship prevents such activities
- *Hijacking the chair*, in other words taking over the running of the meeting. This can only work if the chairman is new or ineffective
- *Refocusing the debate* when the tenor of the meeting is running against the manipulator's interests. There are a number of devices that can be used. Talking around the subject, whilst shifting the discussion onto favourable ground, is a particular skill of the meeting manipulator. Profound irrelevance is his or her stock in trade. But filibustering to run the discussion out of time will seldom work in the boardroom
- *The 'put-down'* involves the skilful introduction of doubt when responding to a proposal before the board. Good put-downs often adopt an air of superiority, as in '*we discussed this matter before you joined the board and decided against it*'.
- *Presenting ideas in the context of other people's* can be powerful: '*I was inclined to believe . . . until I heard X, now I am sure we should . . .*' The fact that X was advocating something quite different is not the point.
- *Summarizing* the discussion thus far can be used to emphasize favourable points and down-play others: '*What the meeting seems to be saying is . . .*'
- *Pre-determining the outcome* is an extension of the summarizing device used to foreclose discussion by stating the outcome of a decision, preferably in Latin, as in: '*Chairman, we seem to have reached the decision nem con*' (nemine contradicente: no one against), whether anyone is against or not
- *A challenge*, when a discussion seems to be flowing against the manipulator's interests, can be persuasive. '*On a point of order, chairman*' is a call, which if offered with sufficient challenge and conviction will stop an orator in full flight. Strictly, points of order are only relevant if there are standing orders covering the running of the meeting; but that will not deter a skilful meeting manipulator
- *A call to the chair* that the discussion has strayed from the point of the agenda item, that irrelevant issues are being raised, or that the discussion would be more appropriate under another item, can be used to deflect an ongoing discussion that is moving against the manipulator's interests
- '*Any other business*' on the agenda can also be used to re-open debate or introduce new items. However, the chairman may insist that only items previously notified can be discussed and that no papers can be tabled. No matter. The manipulator will use the agendum '*date of the next meeting*' to introduce a new topic, explain the issue, hand out the papers, express an opinion, or suggest further discussion, or the formation of a sub-committee with him or her in the chair. '*We need to look into this issue with the care and attention it deserves*', ensuring that the sub-committee has a majority of those who favour the idea
- *Calling for a postponement of discussion* until the next meeting, on the grounds of the lack of information, the need for more reflection, or until an absent member is present, can also be used to postpone a decision that seems likely to be decided against the manipulator's interests

- *Calling for an adjournment of the meeting* is a heavier version of the postponement device
- *Lack of a quorum* can be used to stymie a decision, if the articles of association or the rulebook specify a quorum, the lack of a quorum will prevent further decision making
- Finally, the *management of the minutes* can provide a crucial opportunity to manipulate a meeting

Box 10.1 A Few Thoughts on Boardroom Communication

- '*In my experience . . .*' is one of the most over-used phrases in board discussions. The issue is whether that experience is relevant
- '*To tell you the honest truth . . .* ' should ring warning bells about the veracity of the information
- '*. . . trust me on this*' is a phrase frequently used to avoid rational debate
- '*These financials are a load of rubbish*'—some comments invite retaliation rather than rational dialogue
- '*That'll never work in a month of Sundays . . .*'—attacking proposals on the table is usually less productive than offering alternatives—'*I wonder whether we might also consider . . .*'

Some will say that this section on game playing and meeting manipulation takes a cynical view of board level interaction. Others will believe that it more closely mirrors their own experience of boardroom life than explorations of board structures and codes of good governance practice. What is undoubtedly true is that the reality of boardroom life involves people, power, and politics as much as rigorous analysis and rational debate.

Board Styles

It is apparent that boards differ considerably in their culture and their style. Some boards are highly professional in their operations, with experienced, well informed, and collaborative directors, often holding strong views and engaging in tough-minded but amicable debate. Outside directors are closely involved in decision making and share a common view of the corporate strategy. Deliberations in such boards tend to seek consensus and votes are rarely taken. The boards of many listed companies in Western cultures fall into this group. We recognized some significant differences in board culture in other countries in chapter 8.

However, even in Western cultures the behaviour of boards is not always professional. For example, board culture can evolve into a comfortable, convivial relationship between the directors. Outside directors may ask questions but not probe in depth, and offer suggestions but never challenge the executive. In board deliberations such directors tend to support each other and do not have tough-minded exchanges. In such companies the climate in the boardroom is cosy, in fact, more like that of a country club.

Case Study 10.1 Independent Insurance

In June 2001, the board of the UK company Independent Insurance was told by advisers PricewaterhouseCoopers (PWC) that the company was insolvent, its liabilities exceeding its reserves and assets by a quarter of a billion pounds. A provisional liquidator was appointed. Yet only six months earlier Independent Insurance appeared to be worth over £1 billion.

The company had been floated on the stock market in 1993 and many analysts favoured the shares. The last published accounts in 2000 showed an operating profit of £40 million, although cash outflow was somewhat higher, and the auditors, KPMG, reported that the accounts showed a true and fair view of the state of the company's affairs. Actuaries, hired to review the company's exposure to risk, claimed that the reserves made reasonable allowance for possible claims. Annual returns were duly filed with Companies House and the Financial Services Authorities. Six months later the company had collapsed.

What went wrong? Where were the checks and balances supposed to be provided by the board with independent directors, the auditors, the actuaries, the analysts, and the regulators?

For fourteen years Michael Bright had been managing director of Independent Insurance. A man of undoubted entrepreneurial flair, he had many fans in the City of London for his unique way of doing business and the company's '*superior underwriting strength*'. But he was a forceful and charismatic character and, as his reputation grew, he became less and less willing to brook challenges to his authority.

One by one his fellow executive directors left. Robert McCracken, head of British regional business left in 1997; Keith Rutter, responsible for liability underwriting, in 1998. A third member of the triumvirate that had previously kept Bright in check, Alan Clarke, retired in 1999. The other significant executive director, Philip Condon, the Deputy MD, was a close friend of Bright. Garth Ramsay was non-executive chairman of the board and Sir Iain Noble was another non-executive director. KPMG charged £667,000 for their audit, but consultancy and other services produced nearly another million pounds.

Financial problems facing Independent Insurance mounted in the first six months of 2001. A number of reinsurance contracts had been negotiated with GE Capital against the possibility of mounting claims. As the financial situation deteriorated Garth Ramsay, the chairman, replaced Michael Bright. He sought more information on the reinsurance contracts and was horrified to learn that, instead of the substantial cover anticipated, Independent was exposed to a potential liability of many millions. The company had been under-reserving for years. Risks had been insured at cut prices without board approval. There was a major deficit in the company's reserves and, being unable to cap this exposure, further equity could not be raised.

Discussion Questions

1. What went wrong at Independent?
2. How might this have been avoided? Consider board membership, board leadership, and board level information and control systems.
3. Were the auditors at fault?

Then there is a category of company in which the board provide little more than a legalizing rubber stamp for decisions taken elsewhere. As we shall see, there are some situations in which such a situation can be legitimate.

Then there is a fourth category of board which has members representing different interests. A hospital board, with different board members from the hospital administration, the medical team, representing the patients, and possibly the funding bodies, would be an example. In such boards, members tend to take positions that reflect the interests of the groups they represent. Debates can be lively and votes are often called for on issues. The boardroom style, in fact, is more like that of a parliament.

What determines board style? Board style is a function of a number of variables, first and foremost the board leadership, the role adopted by the board chairman. We will study alternative approaches to board leadership in the next section. The size of the board can affect its style: too many members and the opportunity for individuals to contribute become limited and the board may divide into factions; too few and there may be insufficient diversity of views. The balance of the board between executive directors, CNEDs, and INEDs will clearly affect the tenor of board deliberations, also the balance of experience and background among the board members. The actual set of attributes among all the directors—their combined experience, knowledge, and skills—is also a major causal factor in determining board style.

The culture of the board, including its history, its past leadership, and previous events affecting the business, will also influence its style. The following set of criteria lists various attributes affecting board style and shows some of the likely effects. Notice the range of differences that can exist between boards.

Board Traditions

In some boards rituals and customs mean a lot. Corporate stories and traditions are frequently mentioned. Board procedures and precedents are well established. Many members of the board are likely to be long serving. There is probably a formal boardroom and there may be pictures of past chairmen on the wall. At the other extreme are boards with no time for tradition, in which board practices change readily. The average length of directors' service is short. Informality is the keynote of their meetings, which are held wherever it is convenient.

Corporate Vision

This attribute of style indicates the extent to which directors share the same strategic vision about the company's present position and its future direction and prospects. In some companies all of the directors can readily articulate the company's mission and strategic situation: in others directors either do not understand the company's strategic context or, worse, disagree on what it is.

Innovation

Here the issue is the extent to which each director is expected to contribute new ideas. In some boards all ideas are welcomed, even if controversial. In others new thinking is

discouraged, developments are expected to fit established norms, change is resisted, and past successes influence views on the future.

Control

This reflects the way the board accepts responsibility for exerting overall control over the enterprise, if necessary becoming involved in responding to business problems, or delegating that responsibility down to management through the chief executive.

Decision Taking

Decision taking may be strongly influenced by one person or a small group of directors, in which case there may be little analysis and a lot of dogmatic statements; or decisions may be reached after a lot of talking leading to an eventual consensus among all directors.

Leadership

In some boards authority is jealously guarded by one or a few of the directors, with other board members expected to give advice only when called on. In other boards, the leadership style encourages all directors to contribute to board deliberations, with people respected for their experience, knowledge, and wisdom, and encouraged to contribute.

Commitment

At one extreme are those boards whose members show a low commitment to the board, with high levels of self-interest; at the other extreme all directors are highly committed to the company, the board, and their fellow directors.

Adaptability

Some boards are slow to adapt to changing circumstances. Consequently, board meetings tend to be predictable. Whereas other boards are highly adaptive, with flexible responses to changing situations, even though their meetings can sometimes be turbulent.

Collaboration

In some boards the directors support each other, ensuring that everyone is informed, involved, and committed. At the other extreme are boards whose members tend to compete with each other, showing distrust, poor interpersonal relationships, even hostility towards one another.

Conflict

Board level conflict can be either desirable or destructive. Conflict that is creative, with tough-minded but courteous interactions between people who say what they believe but

try to understand conflicting points of view is found in some boards. In others overt conflict may be discouraged, but then there may be behind the scenes political activity.

Relationships

In some boards, directors see themselves as part of the board team, and treat each other with frankness, respect, and trust. In others, directors act as individuals, rather than part of the board team. In such cases image building, posturing, and boardroom games may be prevalent.

Communication

Access to information, as we have seen earlier, is a source of potential board level power. Consequently, in some boards directors guard the information they have, protecting their sources, and encouraging secrecy. Gossip and grapevine communication is likely to be prevalent. Other boards, however, seem to encourage open communication with a ready exchange of data, information, and knowledge.

Status

Directors' perceptions of their status can be important, with visible signs of the directors' prestige being important, with formal, even ritual, meetings, and probably with ornate boardrooms and elaborate meals. Conversely, in other boards status is relatively unimportant, with directors seeing each other as equals, and not needing ego-reinforcing signals to be sent to the rest of the organization or the outside world.

Conformity

Some board chairmen, believing that a board has to be united, expect their directors to conform to group norms. Non-conformists are not tolerated, indeed they are unlikely to be appointed in the first place. By contrast other chairmen welcome non-conformists, recognizing that they can bring fresh insights and enliven board thinking.

Trust

As we have seen trust is the underpinning of the concept of the corporation. Typically this refers to the fiduciary duty owed by directors to their shareholders. But the relationship *between* directors also plays an important part. In some boards directors trust each other implicitly. But it has to be noted that in others trust can be low and directors suspicious of each other. As we will see later, much hinges on the ability and leadership style of the board chairman.

Some of these characteristics of board style reflect relationships at board level and the way the board members work together. Others affect how well the board does its work and achieves its goals. The challenge is to balance concern for relationships with

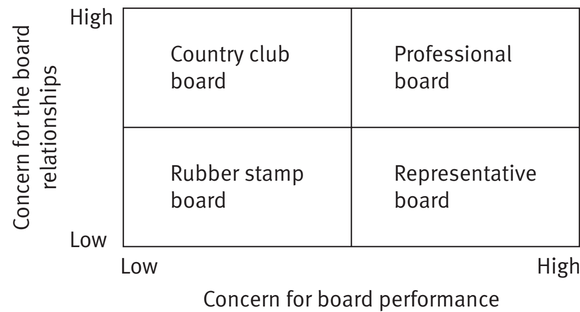

Figure 10.1 Different board styles

concern for achieving board success. The simple matrix in figure 10.1 contrasts a board's concern for the relationships between its members with its concern for getting the job done.

Firms scoring well on both relationships and task can be considered to have a professional style. Those scoring low on each count are rubber stamps, which can be appropriate in subsidiary companies that are managed through a group management structure, or in 'letter-box' companies incorporated to protect a name, limit liability on an exposed risk, or for tax planning purposes. Performing higher on task than on relationships is the representative board that we saw in the hospital board example earlier, whereas high on relationships but poor on task is the hallmark of the country club board style.

The characteristics listed above can be used as the basis for a board level exercise to plot a board's style. Obviously, the results reflect the perceptions of those making assessment on the range between the extremes for each criterion. The exercise can be used in director development or form part of a board performance assessment exercise.

The Significance of the Chairman

The preceding material has highlighted the vital significance of the chairman in creating and managing a successful board. Even though composed of brilliant and highly experienced individuals, a board is not likely to be effective unless it is well led. That's the prime role of the chairman.

Many people speak broadly of the chairman of the company, whereas the role is strictly chairman of the company's board of directors, although he will usually chair the meetings of the members of the organization. As we saw in chapter 3, subject to anything in the company's articles, the directors elect one of their own members to the chairmanship. There are few statutory requirements for the role, so chairmen vary considerably in the way they carry out the responsibilities. At one extreme is the powerful chairman who acts as a figurehead for the company, influences its strategic direction, interacts strongly with the chief executive, and provides wide ranging leadership of the board. At the other extreme the chairman does little more than manage board meetings.

Before proceeding there are some problems of nomenclature to settle. Although the chairman of most major companies are men, many women occupy the position in quangos

and not-for-profit organizations. To avoid the use of the inelegant term chairwoman, some boards refer to their board leader as Lady Chairman or Madam Chairman. Others have adopted the genderless title of 'chair', as in 'the chair announced the results'. Here we will avoid confusion and controversy by using the word 'chairman'. Another confusion can arise with the term 'Executive Chairman', which is typically used to indicate either that the holder has a full time commitment to the office, rather than being part time as is frequently the case, or that the chairmanship and chief executive roles are combined, as in the boards of many American companies.

So what should a chairman do? In the opinion of the Cadbury Report:

> The chairman's role in securing good corporate governance is crucial. Chairmen are primarily responsible for the working of the board, for its balance of membership subject to board and shareholders' approval, for ensuring that all relevant issues are on the agenda, and for ensuring that all directors, executive and non-executive alike, are enabled and encouraged to play their full part in its activities. (It is important for chairmen to ensure that executive directors look beyond their executive duties and accept their full share of their responsibilities of governance.) Chairmen should be able to stand sufficiently well back from the day-to-day running of the business to ensure that their boards are in full control of the company's affairs and alert to their obligations to shareholders.

The following six functions for a chairman elaborate the above perspective:

Management of the Board

Leadership of the board team is the chairman's primary duty. This provides the foundations of the board's style. The chairman should play a pivotal role in determining the structure and size of the board, along with the nominating committee and subject to the articles. This involves determining the balance between executives, INEDs, and CNEDs, if there are any. The chairman will normally want to be involved, with the nominating committee, in the identification, selection, and nomination of directors. He will want to ensure that they have the necessary qualifications and experience, that they will fit into the existing board culture, that they have the time to devote to board activities and have no conflicting interests. After all these are to be members of the team that he is responsible for leading.

Following appointment, the chairman will often brief a new director on the corporate situation and board practices and will want to ensure that the director's induction programme is adequate. The chairman also has a vital role in reviewing the performance of each director, a responsibility which in the past was often informal and casual but is now formally expected under some of the corporate governance codes. Similarly the chairman needs to ensure that director training, updating, and development, both for individuals and the board as a whole, is appropriate: again an expectation of some governance codes. The duties, membership, and chairmanship of board committees also need to be managed by the chairman. Finally, he needs to initiate the project that evaluates the effectiveness of the board and board committees and follow through on necessary changes within the board and its policies, procedures, and processes.

Management of Meetings

This is the conventional view of the role of chairman and for most directors the most visible. In the management of board meetings the board's style is seen in operation. Prior to the meeting the chairman needs to consider the time, location, duration of the meeting,

and who should attend, both as statutory members, but also to provide information or to observe. He has to agree the topics on the agenda, not only the conventional ones but any issue that he feels the board should be aware of and discuss. He should ensure that each director is adequately and appropriately informed, not only through routine board reports but with individual material and briefings if necessary. In conducting the meeting the chairman needs to ensure that each director has the opportunity to contribute, that different points of view are succinctly summarized and that the board, as far as possible is led to a consensus on the outcome. Getting directors involved, restraining the dominant, encouraging the hesitant, whilst focusing attention where needed, and balancing the available time appropriately between topics is the essence of good meeting management. The diffident director may seldom speak but when he does his insights can be worth more than many tedious moments from the garrulous. The chairman should beware of the pitfalls of 'group-think' and game-playing, and encourage independence of thought in his boardroom. We will explore some of these matters further in chapter 12 on board effectiveness.

Strategic Leadership

Some boards delegate a lot of the responsibility for developing the corporate strategy to the CEO and top executive team. We discussed this in chapter 6 on the functions of the board. Nevertheless the board is still responsible overall for setting the direction for the firm. So the chairman needs to ensure that appropriate board attention is given to strategy formulation and policy making, and should stimulate strategic thinking at board level. It is the chairman's duty to ensure that all directors understand the company's mission and its strategic context, and share a common view of the strategic direction being followed.

Linking the Board with Management

Where the chairmanship is separate from the chief executive role (as is recommended or required in all the corporate governance codes, except those reflecting practices in the US), the relationship between the chairman and the CEO is one of the most crucial, the most sensitive, and the most subtle relationships in the organization. The relationship is crucial because these are the two most important roles in the entire organization. It is sensitive because these may be people of significance with high public profiles, and big stakes can be involved. And it is subtle because it involves close liaison between two people who each have the power to affect the other. At its best the CEO perceives his chairman as a wise counsellor, someone with wide and relevant experience, and a person to be trusted implicitly; whilst the chairman sees his CEO as the best and most successful appointment the board has made. Some of the problems with the combined chairman/CEO role become apparent in this analysis. At times, of course, even with split roles the relationship can prove to be difficult. Typical problems arise through a clash of personalities, if the chairman interferes in the executive running of the business, or when events call for the disciplining or ultimately the replacement of the CEO. The 'promotion' of a retiring CEO to the chairmanship (discouraged or prohibited in some governance codes) can also be a recipe for disaster, unless he can adapt to the new responsibilities and leave the running of the business to the new CEO.

Arbitration Between Board Members and Others

An occasional role that some chairmen find themselves called on to play is to arbitrate between feuding members of the board, the shareholders, or other involved parties. In some such cases the best advice may be for the parties to see their lawyers. But a respected chairman can, at times, provide wise counsel and conciliation to the benefit of the parties, the board, and the company.

Being the Public Face of the Company

Finally, we come to a role that chairmen of major corporations are increasingly expected to fulfil, that of being a figurehead for the board and the company. Where the chairman takes on this role, the CEO can focus more specifically on running the business, which can be useful given the current climate of corporate complexity and change.

As a public face for the company the chairman might be called on to interact with shareholders, institutional investors, and financial institutions, to meet with customers or clients for the company's products, and to represent the company in the external world of public inquiries, media investigations, and public relations exercises.

Although, some corporate governance codes now give the role of interacting with institutional investors and financial analysts to the senior independent non-executive director, in other cases this can fall to the chairman. Occasionally, the chairman will represent the company, providing a shareholder perspective to the workforce and management. But treading on the chief executive's legitimate territory needs to be avoided. As the figurehead the chairman could be called on to make public statements, to appear at inquiries, to host representative meetings, as well as meeting in small groups and one on one with significant people.

Case Study 10.2 Iceland

Malcolm Walker was the chairman of Iceland, a UK frozen food firm, and the 5th largest food provider in the UK. In late 2000 he cashed in the bulk of his shares in the company for around £13 million. Five weeks later the company issued a profits warning that sent the share price crashing. Walker avoided the immediate aftermath of his action by going on holiday and on his return announced he was retiring. When castigated in the press for selling his shares, Walker claimed that he had done no wrong: his board of directors had full knowledge of the sale and had sanctioned it.

Discussion Questions

1. What information should the board have had before sanctioning the sale of Walker's shares? Were they told of the daily figures, which were, no doubt, already pointing to the profits warning? Did they question what the impact of the sale might be on investor confidence and the share price?
2. How can directors balance allegiance to their chairman, who probably nominated them to the board and relies on their support, with their primary duty to the company and its shareholder members?

Obviously, each chairman brings a different style to the leadership of the board. Some have a light touch full of humour and charm, others bring a decisive, no-nonsense approach, and a few are downright Napoleonic. Chairmanship of a board or board committee is challenging. Successful chairmen will often claim that the success is due to their team. But that team needed good leadership.

Incidentally, some companies use the title Vice-Chairman to spread the work of the chairman; others use the title to indicate the chairman-elect; and it is used by a few boards to confer prestige without necessarily giving additional responsibilities or powers. As Robert Lacey wrote in *Detroit's Destiny*:

> Chairman, Vice-chairman, President—the titles do not always mean quite what they seem. Analysing the hierarchies at the top of American public companies can be a little like working out where real power lies in the Kremlin. The man at the top of the pecking order may, indeed, be the big potato, but it is just as likely that he counts for nothing at all.

Implementing Corporate Governance Below Board Level

Although the need for sound corporate governance is widely accepted in boardrooms around the world, and despite the basics of corporate governance being clearly articulated in principles and codes, many directors and particularly board chairmen still question how it applies in their own case. They ask, for example:

- What is the *real* role of the board?
- How should a board relate to top management?
- How should the board balance collaboration with control?
- What should a board delegate to management?
- How much freedom of action should the CEO have in practice?
- How can a unitary board contribute to performance whilst ensuring conformance?

In an earlier chapter the recommendation was made that boards should establish a policy on decisions that are retained to the board, that is those that cannot be delegated to management. But the above concerns go far beyond the establishment of a formal checklist of retained decisions. They go to the heart of the board's role, the directors' work, and the way corporate governance links with management. In particular the leadership role of the chairman comes under the spotlight.

Surprisingly perhaps, answers to the questions posed above vary significantly between companies and between cultures. Much depends on how corporate governance is perceived and, particularly, on the attitudes and competence of the chairman.

In chapter 8 we reviewed various models of corporate governance around the world and saw how cultural concepts affected practice.

In the UK/Commonwealth model, the principles based comply or explain approach to corporate governance gives boards freedom to interpret the relevant corporate governance code and allows directors considerable freedom to determine their relationship with management. In these circumstances boards face a range of options. These are reinforced

by the separation of board chairmanship from the CEO. At one extreme the directors can delegate power over the business of the company to the CEO and his or her management team, in effect discussing and eventually approving strategies, policies, and plans proposed by management, then ensuring that the proposals are followed and the expected results achieved. At the other extreme, the directors can retain power over much of the strategic direction and planning of the business, requiring the CEO and his or her management to carry out those plans and be accountable for results. In between the extremes the delegation of power from the board to management can vary considerably and may change as chairman, directors, senior managers, or business circumstances change.

In the United States model, the rule based approach to corporate governance gives boards fewer degrees of freedom. Combining the roles of board chairman and CEO concentrates power in that person. The top management team, who report to the chairman/CEO, runs the business operations whatever and wherever they are. The chairman/CEO is then accountable to the board, and in effect becomes the lynch-pin between the board and the management. The presence of one or two other executive directors, say the COO and the CFO, on the board typically only serves to reinforce the chairman/CEO's position.

In these circumstances, the board consists predominantly of independent non-executive directors, perceives its role as advising the chairman/CEO perhaps questioning the strategies, risks, and resources, ensuring conformance to plans, and confirming compliance with legal requirements. Though the board is responsible for the CEOs remuneration and contract, disciplining a successful and strong-minded CEO can be difficult. Some critics have suggested that this form of board is closer to the European two-tier supervisory board model than the UK/Commonwealth model, given the abundance of independent directors. The primary differences being, of course, that the American board *does* have some executive directors, probably the CEO and perhaps the COO and CFO, whereas in the European board no common membership is allowed between the supervisory board members and the executive.

The powerful chairman/CEO is at the apex of the American model of corporate governance. This fundamentally differentiates the perception of the board's role and its relationship with management from the UK/Commonwealth model. The American model tends to see the board as a group of independent outside directors, whose experience and knowledge provide advice and oversight. Primarily their power lies in their duty to appoint, assess, and ultimately, if necessary, sack the chairman/CEO. But overall responsibility for the company then lies with the powerful CEO/chairman. Indeed this has caused shareholder activist Bob Monks to question whether boards of some American corporations have ever really understood corporate governance.

In the Continental European model, the two-tier board structure, as we have seen, attempts to overcome the fundamental problem of the unitary board by separating the performance role of the management board from the conformance responsibility of the supervisory board. Thus, unlike the unitary board, no single body is responsible for both performance and conformance. Consequently the relationship between the board and management has quite different dimensions from the unitary board model. In the two-tier model the relationships between the members of the supervisory board and the top executives on the management board is fundamental. Experience shows that, although the separation of performance and conformance functions between the two boards is

conceptually appealing, in practice significant problems can arise between the supervisory board and top management.

In the family-centric model of Asian corporate governance, the head of the family is typically the head of management as well as leading the board. In the *keiretsu* and *chaebol* models of Japanese and South Korean corporate governance, power to determine what decisions are delegated from board to management is often heavily centralized. While in the state owned or state dominated models of Asian corporate governance, the state often retains the power to appoint directors and influence the work of the board, which in turn determines what is decided at board level and what is delegated to management.

The implementation of corporate governance below board level goes to the heart of corporate governance: it is about the reality of power. Who wields what power over the corporate entity and in what way? The ultimate challenge is to achieve compliance with competence. Such dilemmas are still unresolved in some companies, and become particularly apparent if the company's activities become international and the directors have to face alternative perspectives.

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USEFUL WEBSITES

www.charteredsecretary.net and www.icsa.org.uk
Institute of Chartered Secretaries and Administrators (UK). Best practice guides and other publications.

www.companydirectors.com.au
Australian Institute of Directors.

www.conference-board.org
The Conference Board (USA).

www.hkiod.com
Hong Kong Institute of Directors.

www.iasb.org/Home.htm
International Accounting Standards Board.

www.iod.com
Institute of Directors (UK).

www.iodsa.co.za
The Institute of Directors—South Africa.

www.nacdonline.org
National Association of Corporate Directors (USA).

www.sid.org.sg
The Singapore Institute of Directors. Useful links to other corporate governance sites.

www.tdc.ca/respons.htm
Check list of director responsibilities.

PROJECTS AND EXERCISES

1. Review the section on board level games and meeting manipulation. Develop other examples in each case that might be used to illustrate the idea.
2. Use recent examples of corporate problems, discussed in the financial press, to identify examples of the effect of power on board level situations.
3. Prepare a set of guidelines for chairmen of listed companies, outlining their duties.
4. In groups of eight or ten simulate a board meeting.

SELF-TEST QUESTIONS

To confirm your grasp of the key points in this chapter try answering the following questions. Answers are at the end of the book.

1. What is the fundamental basis of board power?
2. Name some other ways in which a board can find itself influenced.
3. What is the knowledge power that a director might have?
4. Name five other sources of director power.
5. Name four different board styles.
6. What criteria affect board style?
7. What is a chairman's primary duty?
8. Name six functions of a chairman.
9. Explain the chairman's role in strategic leadership.
10. In what ways might a chairman be the public face for the company?