EBF's Spring 2001 Forum asked contributors to consider whether Corporate Governance is delivering value for company stakeholders. A range of articles traced the origins of the main ideas, debated whether there is a distinct and emerging European governance model, and highlighted flaws in current systems. The article here – a reaction to the Forum – is a timely reminder that corporate governance is something much more dynamic than a set of rules which have to be observed.

Board performance, not just board conformance

by Bob Garratt

The **EBF** Spring 2001 issue *Is Corporate Governance Delivering Value?* signals a refreshing approach to the rather stalled debate on how corporate governance will develop. But there were still hints in some articles of what one might term the conformance-based mindset which most directors find too restrictive and which I certainly believe is too narrow. The comments from Valter Lazzari – that "corporate governance can be seen as the set of institutions, practices and rules to prevent expropriation of outside investors by insiders or dominant shareholders" and (elsewhere) that "most major insights into corporate governance, and contributions to the debate, have come from the finance field" – are symptomatic of current thinking. I would argue, by contrast, that until the study and practice of appropriate behaviour and values behind the boardroom door is elevated to equal status with the compliance issues then we will not have effective corporate governance.

As a speaker at a conference on corporate governance in Paris not long ago I was hissed as I started to speak and was told by members of the rather irate audience, ENArques and French senior politicians, that "corporate governance" is well-known as an Anglo-Saxon plot to destabilise La Francophonie. This is patent nonsense. The issue of effective board performance is not simply a US versus Europe battle, it is a universal struggle. Indeed, the US and UK models differ significantly so the notion of an 'Anglo Saxon' bloc fails. The issues, especially the abuse of directoral office, are global and are found daily on the front pages of newspapers and on TV screens in both the developed and developing world, in the private and public sectors, in not-for-profits and in non-governmental organisations.

Effective corporate governance is about the exercise of the complex relationships between ownership, power, trust and anti-corruption processes in the boardroom. To be effective it must be as much concerned with generating wealth for society (board performance) as about staying rigidly within the rules (board conformance). Board conformance is necessary but not sufficient. Sufficiency comes through the exercise of appropriate values, structures and processes in a board to generate added value for the owners, private or public, to achieve their purpose within the laws of their country.

As demands for greater transparency in the board's risk-taking and decision-making processes become more common, increasingly backed by legislation and through the use of internet technology by stakeholders, so the focus of the corporate governance debate will change from the present over-emphasis on basic compliance to the regular assessment of effective board and individual directoral behaviours and the consequent performance of their organisation. This is being driven both by directors' own needs to understand better the roles and tasks of the board in adding shareholder value, and by the need to combat the many abuses of directoral office for personal gain. Both can be countered by annual (or possibly more frequent) appraisal of the board and of individual directors' performance.

What would effective Board Performance look like? I will show two processes which have proved effective in developing more effective board behaviour in diverse countries. The first is the draft list of Ten Duties of an Effective Director which I have produced for discussion at the Commonwealth Association for Corporate Governance. This is a distillation of Commonwealth Law (based on its 54 country members) and highlights the ten most commonly misunderstood aspects of a director's role under that law.

My work focused on ensuring each director, and each board, understood and acted on the three fundamental values to the owners of Corporate Governance:

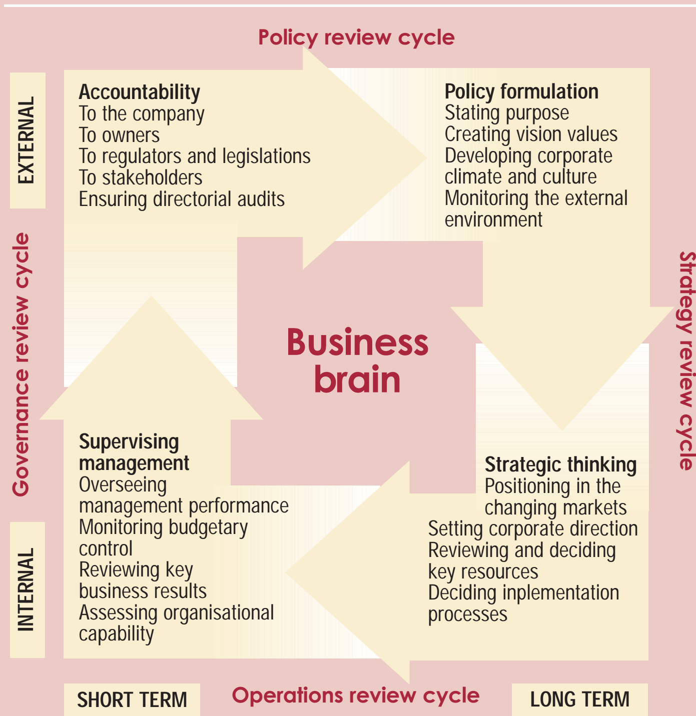
- Accountability.
- Probity.
- Transparency.

It then lists the Duties:

1. Ensuring Legitimacy (staying within the law).
2. Upholding their Primary Obligation (to the company not the shareholders).
3. Upholding their Primary Role (to drive the enterprise forward whilst keeping it under prudent control).
4. Holding the company in Trust (for future generations).
5. Ensuring critical review and debate (around the boardroom table).
6. Upholding a duty of Care (in risk assessment and decision-taking).
7. Upholding the three values of Effective Corporate Governance (Accountability, Probity, and Transparency).
8. Upholding the rights of Minority Owners.
9. Ensuring Corporate Social Responsibility.
10. Ensuring the Board learns, develops and communicates.

For these Duties to be respected, lived and monitored it is

Figure 1: The Learning Board Model



essential that a director is inducted, included and brought to directoral competence. This is the responsibility of the Chairman, not the Chief Executive. A director must be respected for his or her individual inputs and encouraged to exercise personal judgement. The law holds them both jointly and individually liable for their decisions and actions although most directors do not understand this. Neither do they appreciate that they are not the representative of any grouping inside or outside the organisation. Because this so seldom understood, directors then adopt odd behaviours to please their non-existent 'masters'. They do not understand that at the very moment of their appointment as a director the law insists that their loyalty switches from those who appointed them to the company as a separate legal personality. Too many directors feel that this is a career-limiting approach. But legally they have no option.

The second process for effective board performance is to adopt The Learning Board Model which I have developed over the past ten years (see Figure 1).

Using a quadrant model, comprising on the horizontal axis the short-term and long-term perspectives, and on the vertical axis the external and internal perspectives, I have constructed the following sequential flow of work for any board of directors:

- Policy Formulation/foresight.
- Strategic Thinking (not Strategic Planning).
- Supervising Management.
- Accountability.

The details are discussed in my book *The Fish Rots From The Head: The Crisis In Our Boardrooms (1).* I would stress here that this is a sequential process which gives an intellectual discipline to a board's cycle, annual or shorter. Board Performance is determined on the right side of the model – Policy Formulation and Strategic Thinking – and Board Conformance is determined on the left side – Supervising Management and Accountability. The quality of board critical review and debate, under a neutral chairman, is essential as the external and internal worlds change frequently and the complex interactions between the two need constant monitoring for the board to be able to make business sense of the political, physical, economic, social, technological, trade and legal worlds.

From my empirical observations I have found that the key problem points for boards are the debates that are needed where 'monitoring the external environment' and 'positioning in the changing markets' meet. This provides the strategy of the organisation – the broad deployment of scarce resources to achieve its purpose. Underperformance here prejudices the organisation's future. Yet equally important is the debate around 'implementing the strategy' and 'assessing organisational capability'. My research into directors' thinking styles shows that this is the major weakness in their thinking – they do not enjoy the process of implementing a strategy, and are particularly bad at receiving hard facts that show things are not working as planned. The discipline of working through the Learning Board model helps overcome this, as well as giving each board meeting a different focus, thus stopping it becoming a rubber stamp of executive actions.

The public is becoming more demanding of the need for competent directors, rather than managers. In the UK the publication of the Turnbull Report for listed companies in 1999, and the Rutterman Report for the public sector, has helped concentrate minds wonderfully. Listed companies are now obliged to explain to their owners their processes for risk assessment and decision-taking in their annual reports, or explain why they are not doing so. This is causing concern in many boardrooms as it throws up difficult questions of how precisely they do this now. Owners are beginning to ask just what does happen behind the boardroom door. So for directors to just carry on following a powerful Chairman or Chief Executive's gut feel will no longer be enough.

Aspects of directoral professionalism and competence are raising their heads.

The assessment of directoral questions follow quickly from the owners. This goes way beyond the issues of Board Conformance and deeply into Board Performance. The practice of using 360 degree appraisals for all board members has started. This involves both peer and outsider review of the total Board Performance; and individual director assessment through a mixture of Chairman review, peer review, direct-report review, and on occasions customer or shareholder review. I have handled recently the review of the Chairman of one of the UK's major retail banks. Despite the trepidation on all sides beforehand the Chairman found it much less threatening, and more helpful, than he had anticipated. Indeed he has gone public in the bank's newsletter and published a synopsis of the findings and encouraged the staff to help him when he is under-performing in these areas – to the shock of many.

The cosy world of the non-performing director is ending, and quickly. Now boards are under scrutiny from many sides on both their conformance and their performance. The spotlight from investors, pensioners, and the pressure groups will not go away. Indeed it will become more closely focused. In future boards are likely to have to report on a 'triple bottom line' – financial, physical environmental, and corporate social responsibility. To do that board conformance will certainly not be sufficient.

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