



## **Governance and the Effective Board**

### **It's all about Value**

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Corporate governance - the authority structure of a firm - lies at the heart of the most important issues of society such as "who has claim to the cash flow of the firm, who has a say in its strategy and its allocation of resources."

The corporate governance framework shapes corporate efficiency, employment stability, retirement security, and it creates the temptations for cheating and the rewards for honesty, inside the firm and more generally in the body politic. It influences social mobility, stability and fluidity.

It is no wonder then, that corporate governance provokes conflict. Anything so important will be fought over. Like other decisions about authority, corporate governance structures are fundamentally the result of political decisions.

(refer generally *Political Power and Corporate Control: The New Global Politics of Corporate Governance*, Gourevitch and Shinn)

Avoiding prison should not be the objective of the board of directors. It should be to build strong enterprises. - *William W. George, Goldman Sachs*

Good governance exists in the eye of the beholder - *Anonymous*

# Contents

- Internal Governance – a recap
  - (the NZ orthodox version)
- External governance – a recap
  - (market based disciplines)
- Four Pillars of board value
  - Purpose
  - Performance
  - Accountability
  - Compliance

# Internal Governance – Three Preliminary matters

What country/historical tradition/political economy are we in today?

- USA vs UK vs Aussie vs Mexico vs Germany vs Italy

Shareholder structure matters

- TVNZ vs. Telecom vs. Contact vs. CHH vs. the corner diary

Position in growth cycle matters

- Feltex vs. Trademe vs. Life Pharamacies



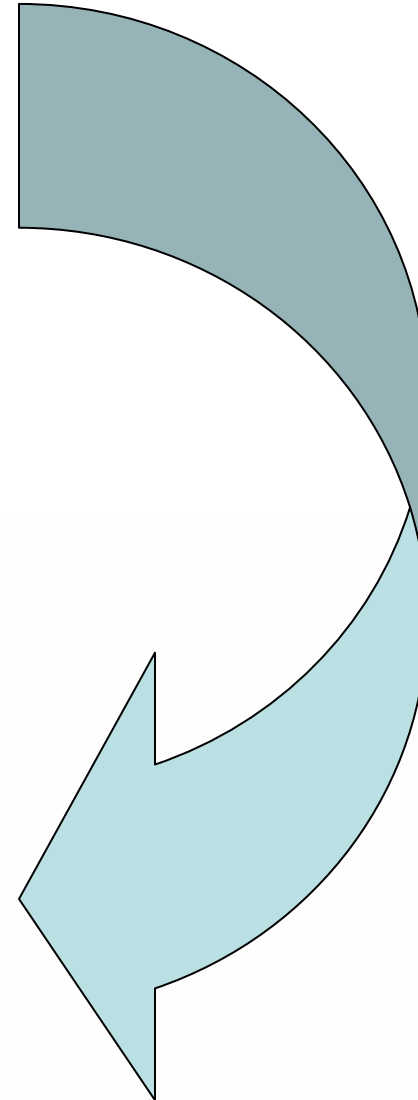
## Company- Assets

### Control and Manage directly?

- Diversified portfolio – no incentive
- No specialised skills
- Unworkable management (transaction costs)
- Governance available?



Shareholders



## The Board

- appointed by shareholders to act in company's best interests with care and loyalty – a fiduciary not an employee
- Ultimately accountable for company

## Shareholders

- Cede effective control
- Residual powers only to appoint, /remove, approve major transactions
- Only realistic sanction is to sell
- Institutional Investors ?



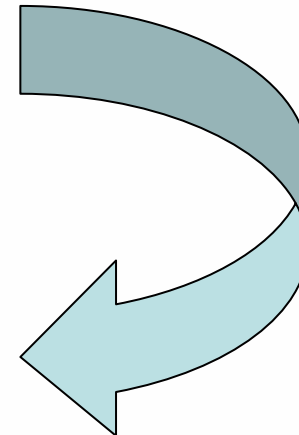
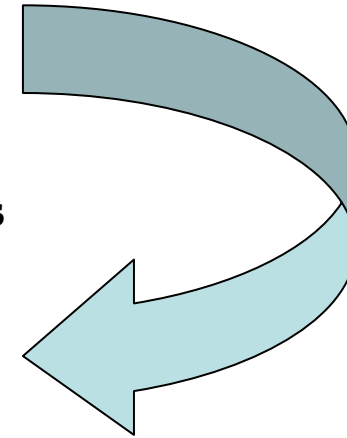
**Company and its  
Assets**

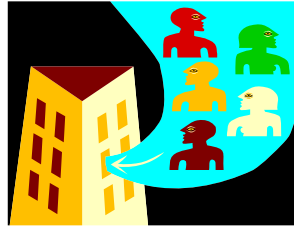


**Board of Directors**



**Shareholders**





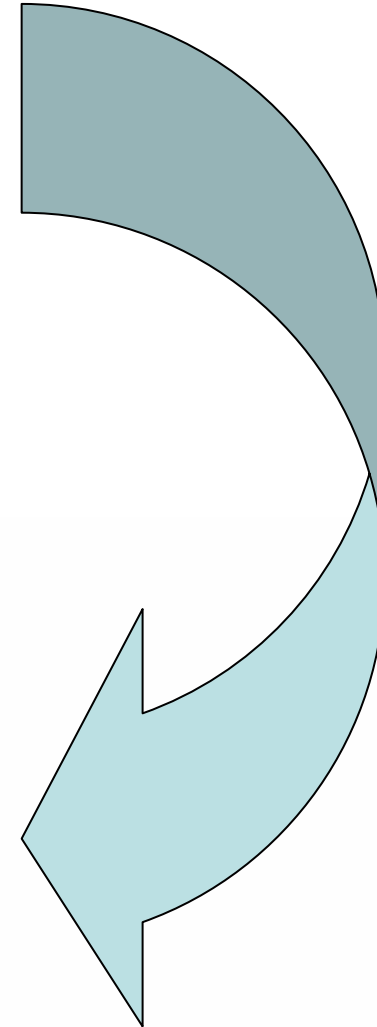
**Company- Assets**

**Control and Manage directly?**

- **Role is to oversee**
- **Cannot manage day to day**
- **Too complex**
- **Skills gap?**

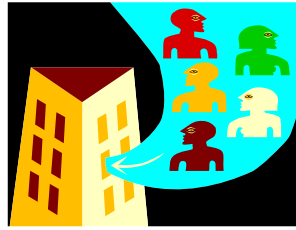


**Board of Directors**



## Management

- A Board agent – Can be fired anytime, at a cost
- Not accountable to shareholders
- Manages the company to the company purpose
- Employees not owners



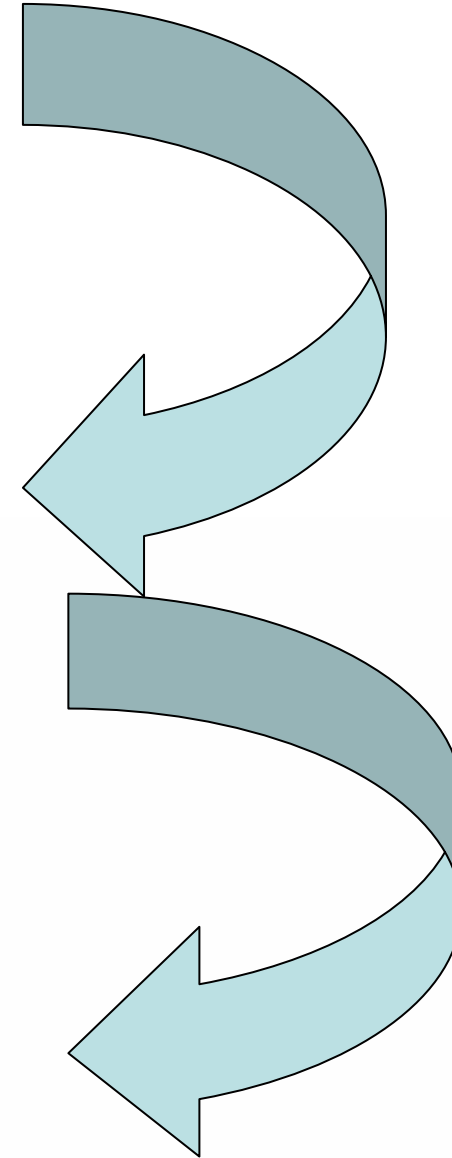
## Company- Assets



## Professional Management



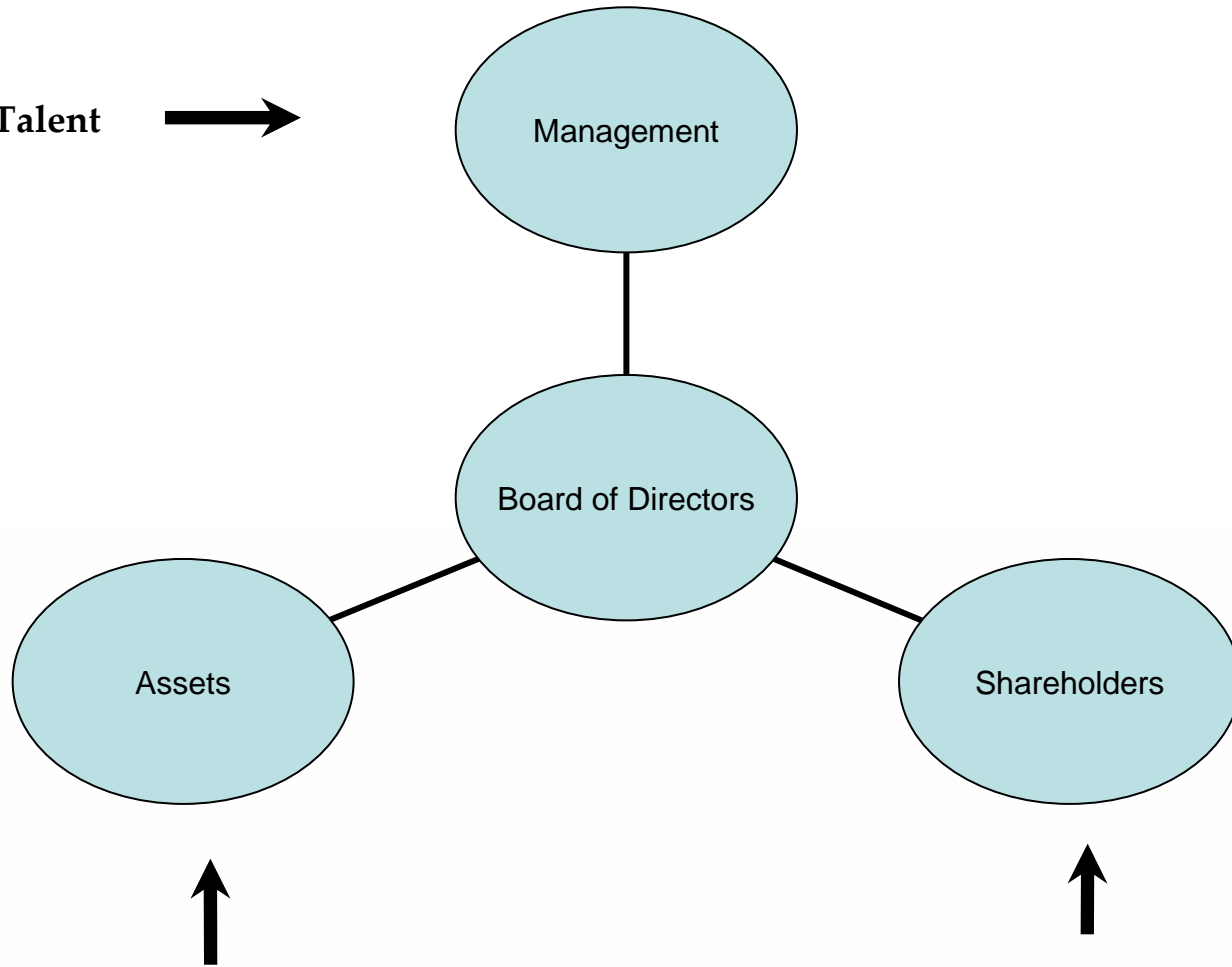
## Board of Directors



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- External governance – a recap
- Four bases of board value
  - Purpose
  - Performance
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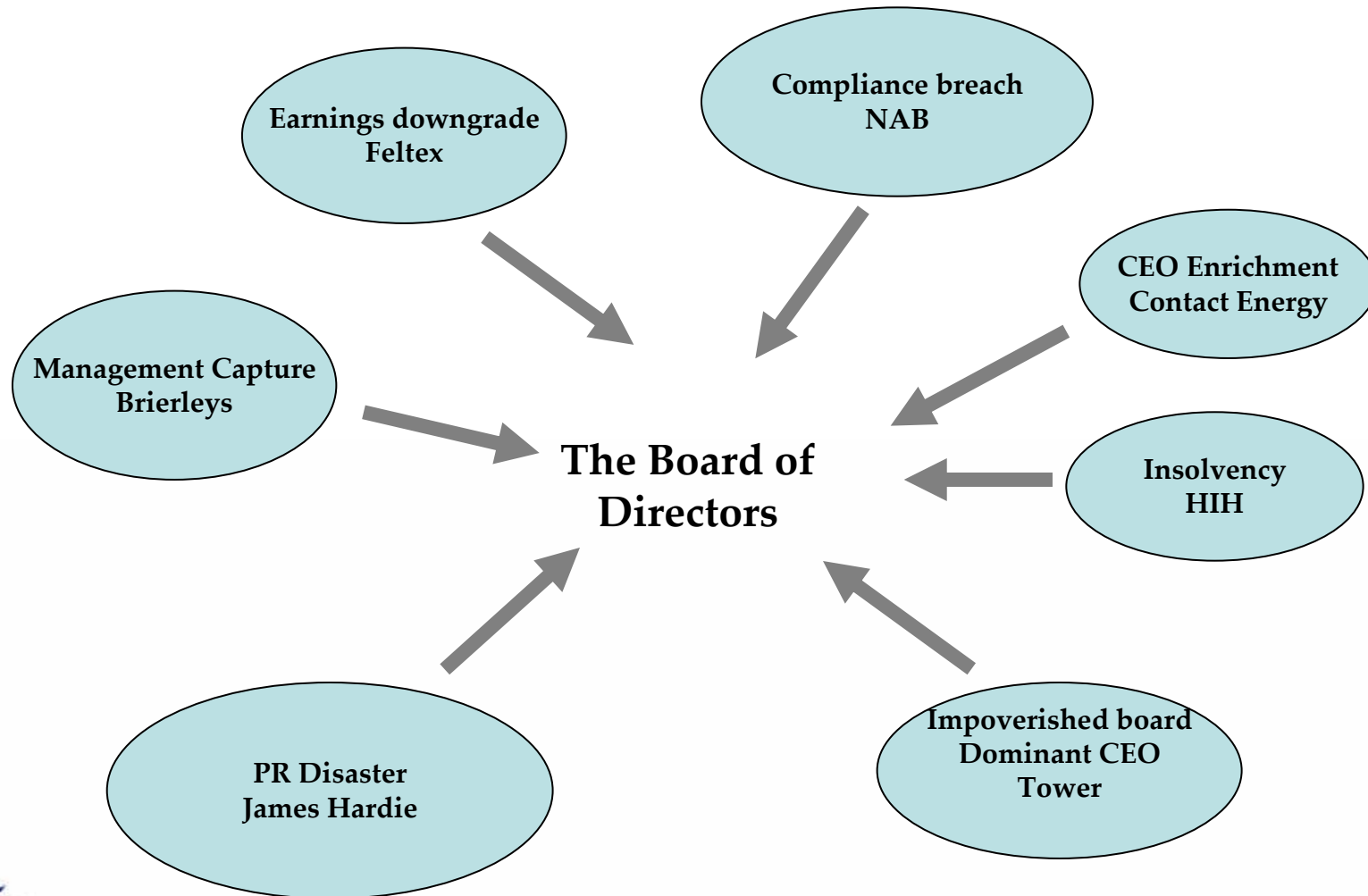
Market for Talent →



Market for corporate control

Market for Capital

# Internal and External Governance – Who fronts?



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# Purpose

- Board is focussed on the company's fundamental purpose
- Develops and understands strategy – with management
  - o Understands competitive space/differentiation
  - o Assesses alternatives
  - o Approves risk
  - o Understands business model/cash flow
  - o Understands plan to grow and why

# Purpose

- Board doesn't take management on faith, less likely to succumb to managerial adventurism
- Board has a framework against which managerial recommendation can be assessed
- Board has the CONFIDENCE to engage fully with the CEO and become directive if required
- Board better able to identify environmental threats and opportunities
- Board can respond more rapidly when required
- Board more likely to become company advocates

# Performance

- Sound board structure and process does not guarantee success
- It's the “doing”, the board culture that counts
- Paradox: Board has most accountability/liability versus least amount of time and narrowest of working modes
- Culture is critical

# Performance

- Dissent is necessary
- Candour, trust, independence, diligence
- Professionalism and focus
- “Group think” minimised
- Role rotation, succession planning
- Board self awareness and self assessment
- A strong ethical sense

# Accountability

- Separation of powers
- There are few overnight disasters
  - Under performance
  - Strategic drift
  - Poor risk management
- Accumulate over time
- An effective board is ready willing and able to ACT and act when required

# Accountability

- An effective board checks and approves that
  - Management has an implementation plan to make the strategy real
  - This plan is deployed through discrete tasks assigned to appropriate resources
  - Progress is measured by valid performance management regimes
- Key litmus test
  - The board has the reasonable conviction that it has the necessary indicators, scoreboards and warning devices in place to monitor management's pursuit of strategic goals.

Stresscrete and Bridgecorp - thoughts

# Accountability

- The key CEO relationship is managed well
- Board has principal impact through the CEO
- A positive relationship
- Trust, candour, accountability, diligence
- Clear role, tenure, responsibilities
- Rigorous performance management

# Compliance

- Solvent and legal
- Risk matched to return
- Stakeholder interests managed optimally
- Policies and delegations clear, effective and current

# Final thoughts

- “Whenever I see a successful business, I know that somewhere someone made a courageous decision” – Peter Drucker
- “For a man who has only a hammer in his toolbox, every problem looks like a nail” – Unsourced
- “There is no such thing as good governance. There are only good companies and poor companies” – Unsourced
- “As much as any company in the world, Enron has institutionalised a capacity for perpetual innovation ... [it is] an organisation where thousands of people see themselves as potential revolutionaries.” – Gary Hamel 2000, Management Expert

# Further Reading

- **Political Determinants of Corporate Governance** Mark J Roe OUP 2003
- **Corporate Governance** John Farrar 2<sup>nd</sup> ed OUP 2001
- **The Anatomy of Corporate Law** Kraakman OUP 2004
- **Corporate Governance and Wealth Creation in New Zealand** Joseph Healy Dunmore Press 2003
- **Convergence and Persistence in Corporate Governance** Gordon & Roe Cambridge UP 2004
- **The Recurrent Crisis in Corporate Governance** Macavoy & Millstein Stanford Business Books 2004
- **The Company** Micklethwait and Wooldridge Weidenfeld & Nicolson 2003
- **A History of Corporate Governance Around the World** ed. Morck NBER Chicago 2005
- **The Economic Structure of Corporate Law** Easterbrook & Fischel Harvard University Press 1991