Role of Board

What is the Role of the Board?

Section 198A of the *Corporations Act* 2001 provides that 'the business of a company is to be managed or under the direction of the directors'. Every company must have at least one director and public companies must have at least three directors. Collectively, the directors are known as the board of directors.

In the case of some other organisations (e.g. incorporated associations), an organisation will be run by a Committee which consists of 'members' rather than 'directors'. The board of directors acts on behalf of shareholders in overseeing and governing a company. Generally, it is the board's responsibility to identify an organisation's direction and goals and management's responsibility to decide how to implement these plans.

In practice, the role of the board is to supervise a company's business in two broad areas:

- **Overall business performance** — ensuring the company develops and implements strategies and supporting policies to enable it to fulfill the objectives set out in the company's constitution. The board delegates the day to day management of the company but remains accountable to the shareholders for the company's performance. The board monitors and supports management in an on-going way;
- **Overall compliance performance** — ensuring the company develops and implements systems to enable it to comply with its legal and policy obligations (complying with statutes such as the *Corporations Act* 2001, adhering to accounting standards) and ensure the company's assets are protected through appropriate risk management.

The differing emphasis of these two areas of business performance and conformance/compliance responsibilities can result in conflicting pressures on directors. For example, personal liability for breaches of the law encourages concentration on compliance while institutional investors and an increasingly aware investing public are insisting on better business performance. Directors must balance these roles and give enough attention to both.

The following model by Professor Robert Tricker provides a useful guide to the performance and compliance director dilemma.

Table 1: Tricker's framework for analysing board activities[1]

	Compliance roles	**Performance roles**
External role	Provide accountability	Strategy formulation
	Approve and work with and through the CEO	
Internal role	Monitoring and supervising	Policy making
	Past and present orientated	**Future orientated**

What are some of the Specific Responsibilities of the Board?

Within the broad framework outlined above, some of the board's specific responsibilities are to:

- appoint a CEO and evaluate his or her performance
- set and review the medium and long term goals of the organisation in consultation with management
- approve budgets
- monitor business performance
- approve large investments and any major financial decisions
- monitor the controls framework to ensure major risks are identified and managed

- challenge the assumptions of management
- ensure there are systems in place to enable accurate financial reporting and so the organisation complies with all aspects of the law
- ensure the continuing development of the executive management team
- determine appropriate remuneration for the executive team
- make provision for succession planning
- communicate with shareholders and other stakeholders
- be accountable to shareholders

What is the Relevance of 'Corporate Governance'?
Corporate governance can be defined as 'the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in companies'. The practical benefits of a company having an effective corporate governance system are that some studies indicate a correlation between good performance and a high level of corporate governance and that corporate governance is a significant factor investors consider when making investment decisions. This focus on corporate governance and the board by investors has been heightened by the global financial crisis.

In Australia, corporate governance of listed companies operates on an 'if not, why not' approach rather than mandatory detailed regulation. This approach means that, in general, a company does not have to comply with the ASX Corporate Governance Council's (ASXCGC)*Corporate Governance Principles and Recommendations*, but, if it does not, then it must outline in its annual report why not. There is no 'one size fits all' set of corporate governance rules and this approach is seen as the best way to provide guidance and at the same time the necessary flexibility.

The ASXCGC *Corporate Governance Principles and Recommendations* cover things such as structuring the board, integrity in financial reporting, disclosure, respecting shareholders' rights, risk management and remuneration. As governance practises are continually evolving the ASXCGC *Corporate Governance Principles and Recommendations* are often reviewed and amended.

What is the Best Skills Mix?
The board needs to have a broad mix of skills, knowledge and experience. Different directors have different skills and backgrounds. The goal in selecting directors is to build a mix that can work as a well-rounded team of people each with an appropriate range of experience. In selecting a director, the board should consider the skills, knowledge and experience needed to govern the company both now and in the future.

It is important to select people who have sufficiently broad experience in the issues and opportunities the company is facing now or is likely to face in the future. While specific skills required by each board differ, there are some core skills that should be represented on a board as a whole (not necessarily in one person).

These include:
- **Strategic expertise** – the ability to set and review strategy through constructive questioning and suggestion;
- **Financial literacy** – the ability to read and comprehend the company's accounts and the financial material presented to the board, in addition to understanding financial reporting requirements - the Centro case (ASIC v Healey (2011)) has emphasised this need for basic financial literacy for all directors;
- **Legal skill** – the boards' responsibility involves overseeing compliance with numerous laws;

- **Managing risk** – include on the board a director with experience in managing areas of major risk to the organisation;
- **Managing people and achieving change**;
- **Experience with financial markets**;
- **Industry knowledge** – experience in similar organisations or industries;
- **Understanding stakeholder expectations**;
- **Information technology** – there is a growing need for directors with an understanding of information technology

Additionally, if an organisation has special needs or exposure to a particular stakeholder group, it makes sense to include a director who has experience in that area. For example, a company that spends a great deal of time doing business with government may need someone with first hand experience of the political process. Care should be taken by boards and individual directors, however, to avoid adoption of the role of specialist advisor.

The ASXCGC *Corporate Governance Principles and Recommendations* have been amended to place more emphasis on gender diversity (see, for example, Recommendation 3.2 – boards should have a diversity policy which has measurable objectives for achieving gender diversity).

Who is Responsible for Decision Making?
All decisions are made collectively by the board and all directors share equal responsibility for those decisions. This collective responsibility, accountability and wisdom with its implicit checks and balances are an important feature of good governance and decision making of Australian boards. Note that the *Corporations Act* 2001 does not give a greater responsibility to the chairman, although there is debate about this in case law. Refer to the **Role of the Chairman**. Arguably however, major failures in good governance have occurred when board decision-making is subordinated to or overly influenced or reliant on that of a dominant individual or expert.

What is the Board's Role in Selecting a CEO?
The most crucial role of the board is to select a CEO. As the implementer of strategy and leader of the management team, the value of the CEO to the organisation cannot be underestimated. The board and CEO are mutually dependent and should aim to work in partnership.

CEO succession planning is another important aspect of the board's role. The needs of an organisation will change over time and a CEO who is an excellent appointment today and in the short term may not be the best person for the longer term. For example, an organisation undergoing a period of major change can benefit from a CEO with skills and experience in this area but may respond better to a CEO with a different skill set when the period of major change is over and the circumstances are more settled. See **Succession Planning** for more information.

What is the Board's Role in Strategic Planning?
Communicating a clear strategy to employees and investors and then implementing it are vital to the success of an organisation. Many boards currently feel burdened by the volume of compliance work they face and feel this leaves them with little time for thinking about strategy. Yet without clarity about what the organisation does and doesn't do, the organisation will have trouble moving forward.

An important part of developing and implementing strategy is to clearly delineate between the roles of the board and management. The level of board contribution to strategic thinking and planning may vary according to size of the organisation and its current situation. Large businesses tend to have a strong and highly skilled executive team who can formulate the essence of strategic direction. In this case, the board's role will centre on questioning, challenging and clarifying.

Questions to ask might include:

- What is the strategic intent?
- Have we considered all options?
- Have we thought left field?
- What are our cost constraints?
- Are there people already doing this?
- What can we learn from other organisations?
- If this is something completely new, do we really want to be the first ones to try it?
- Is the strategic plan looking at a variety of time frames – short, medium and long term?

Management has to implement the strategy so it is important that they support it. In smaller organisations the management team might not have all skills covered and so would benefit from greater involvement by the more experienced board. An organisation in crisis might also require greater board involvement than usual.

To formulate strategy, offsite sessions are generally recommended by business commentators and advisers because they allow a different type of thinking from day to day or regular work to occur. Annual sessions are recommended. An essential part of the implementation is to devise a way of monitoring progress against the plan and to report back to stakeholders regularly. An added benefit of communicating a clear strategy is that it can help to build investor confidence.

What is the Board's Role in Setting Ethical Standards?

Compliance with the law is the minimum standard for running an organisation. There are a whole set of ethical values which govern the way in which an organisation operates. It is now widely accepted that inculcating those values in an organisation's culture is an essential role of directors. Principle 3 of the Corporate Governance Principles and Recommendations is that 'Companies should actively promote ethical and responsible decision-making'.

All directors would do well to listen to the advice of Owen J, who conducted the Royal Commission inquiry into the collapse of the HIH insurance group:

'"Did anyone stand back and ask themselves the simple question – is this right? ...Right and wrong are moral concepts, and morality does not exist in a vacuum. I think all those who participate in the direction and management of public companies, as well as their professional advisers, need to identify and examine what they regard as the basic moral underpinning of their system of values."

Role of CEO and MD

The most senior executive in an organisation is usually referred to as either the Chief Executive Officer or the Managing Director. These terms are often used interchangeably but there are differences in their responsibilities. The CEO is the operational head and the board's employee; an MD fulfils this CEO role but is also a board member, i.e. MD is an **Executive Director**. For simplicity the term 'CEO' will be used in this Director Q&A to refer to both positions.

What are the CEO's role and responsibilities?

The CEO is the head of the executive team and manages the day to day operations of the organisation, its people and resources. The CEO implements the strategy approved by the board and ensures that the organisation's structure and processes meet the strategic and cultural needs of the organisation.

The board's most important role is to appoint and work with the CEO. In practice the two are mutually dependent. Boards rely on CEOs to provide input into strategic development, implement strategy, communicate management's perspective and alert the board to growing issues. The CEO relies on the board for clear direction, mentoring and support.

This relationship is crucial to the organisation's success. It can be hampered by a lack of clearly defined responsibilities/delegations or by either party stepping outside of those agreed terms. This information should preferably be captured in writing, either in the employment contract or a separate agreement. For more information see the Director Q&A on **Relationship Between the Board and Management**.

Specific CEO responsibilities may include:

- Developing and recommending business plans for the board's consideration;
- Submitting reports, budgets and financial statements to the board;
- Implementing all approved plans, policies and programmes and achieve agreed targets;
- Overseeing the financial management of the organisation;
- Maintaining awareness of the business, economic and political environment as it affects the organisation;
- Overseeing the effective operation, administration and development of the company;
- Protect and enhance the image and reputation of the company;
- Ensuring compliance with legal and regulatory obligations.

What are the Advantages of Clear Board Expectations and Delegations of Authority?

The process of formalising the CEO's powers and responsibilities in writing will help the board to clarify its expectations. At the same time the board's responsibilities should be made clear in its own charter. These documents are meant to give both sides freedom to act within boundaries, rather than to constrain.

Conversely, not defining the boundaries of the CEO role means that a CEO has to regularly approach the board for approval of activities and plans. This is an ineffective use of time, does not encourage high performance and misuses the board's skills, knowledge and experience by making them a checker rather than an adviser. By proactively communicating expectations, the CEO is free to work within these boundaries to achieve organisational goals and the board is not left to make decisions on the run.

Examples of delegations that boards typically make to CEOs include:

- Management of major operational activities;
- Financial management limitations, e.g. on capital expenditure and operational expenditure;
- Senior staff appointments;
- Writing contracts;
- Role in strategic planning.

Delegations should be reviewed regularly as a matter of course but may need extra revision if unanticipated situations arise.

What Should a CEO Report to the Board?

Expectations of CEO communication with the board e.g. frequency and format, are also important. Generally the CEO writes a report for inclusion with the board papers for each board meeting and will probably speak at the meeting. To use this opportunity effectively the CEO should focus on the role of the board – governance and oversight – and use the board's considerable expertise to assist with high level issues. Hence the CEO should concentrate on governance-level concerns, not operational matters, and ensure that the board receives the report in time to consider it fully.

The board should think of the CEO's Report as "for information", with matters requiring decisions or substantial discussion being better placed in separate agenda items. The CEO may need to refer matters to the board at other times. In these cases, the chairman is the main contact point.

Relationship Between the Board and Management

A productive and harmonious relationship between the board and management is critical for good governance and organisational effectiveness but can be difficult to achieve in reality. The board and management are trying to achieve the same vision and objectives so a partnership based on trust and respect is more appropriate than a boss/subordinate relationship. Central to this partnership is a clearly defined set of roles, delegations and boundaries which allows each side to respect the other's contributions. The relationship depends on the free flow of information in both directions.

The board is responsible for defining the type of relationship it wants with the CEO and senior executives. This includes explicitly discussing and writing down the boundaries between governing and managing and how best to work together. It then becomes the chair's responsibility to ensure that this is implemented and adhered to.

The board expects management to accept that the board's role is to monitor and question, probe issues, seek clarification, offer insight and share their knowledge and experience. With management much more deeply involved in the organisation, board members rely on them to pass on all information needed for decision making to fulfil their legal obligations as directors. Directors also anticipate that the information provided for board meetings relates to board issues, not management issues. The board expects management to ask advice and make use of the directors' wealth of experience as well.

Similarly, management has expectations of the board. Primarily, they expect that the board will trust them to implement strategy and deliver outcomes without undue interference. The CEO specifically expects from the board clearly stated performance objectives and defined boundaries of authority. Without this direction, the CEO is left to speculate on what they want him/her to achieve. Because the CEO is implementing the board's strategy, he will also expect regular and honest performance feedback. Recognition for achievement, honesty and openness, wisdom and advice, and the ability to use directors as a sounding board are desirable as well.

A Special Relationship Between the CEO and Chair?

There is some debate around whether there should be a special relationship between the CEO and Chair. Two views (*Good Governance*) are:

- CEO should communicate with the board through the Chair. A potential problem is that the Chair does not pass on all information to the board, which can hamper effective decision making.
- The CEO is accountable to the entire board, not just the Chair. Having a special relationship may lead to a boss/subordinate relationship where the Chair effectively manages through the CEO.

This demonstrates the need for clarity about respective roles, and preferably documentation of this.

There will be times where the CEO and Chair may need or want to work closely together eg. to give the market a consistent message or if the CEO wants personal and professional mentoring to benefit from the Chair's experience. In the latter case, this is fine so long as they speak hypothetically and not about specific work issues.

There are no set rules about how frequently the CEO and Chair should meet. They should not need to meet too frequently eg weekly. This may suggest that either the CEO has insufficient power delegated to him/her or that he/she wants all decisions endorsed by the Chair, which blurs the line between managing and governing.