

Dynamics and Behavioural Traits of Boards – A Hands on Perspective on Being an Effective Board Member.

Governance in Context

The corporate governance mantra is being thrown around these days as the panacea for many of the ills inflicting Papua New Guinea. While we should all support this quiet awakening, we should also be cautious that we do not constrain governance concepts to a very narrow view of rules, regulations and standards without inclusion with the human equation –interaction and behavioural aspects in decision-making.

Similarly Corporate Governance can never be the only measure relied on, seen in isolation or as the panacea for institutional failure. Corporate history is littered with failed institutions that had very strong governance regimes in place but because of the Board dynamics (or lack of) and or failure by Boards to act decisively, failure to comprehend future trends, or even plainly misjudging risk, collapsed. This in itself should not be seen as a problem. The market mechanism is not a benevolent passive player that rewards all. What is relevant is that a corporate governance regime coupled with strong Board dynamics (and understanding of) can lessen the chances of institutional failure and also can contribute to the creation of the level playing field. This in turn that improves the performance of market economies and hence provides the very oxygen for companies to thrive.

Why do Businesses Fail?

Simply put, market forces drive less competitive businesses to extinction in a very Darwin style survival of the fittest. It is no different to all things in life. We are born, we grow, we mature, we age, and we die. Similarly business models are forever changing and while one way of doing business a few decades ago was standard, it may be totally irrelevant today. Putting corporate governance issues aside, natural business failure is a very common event. For example more than 70% of manufacturing plants close within a decade in the United States. Similarly 75% of mergers and acquisitions are found to be unprofitable. Economists have traditionally had an answer for this. It is often referred to as the “frequency of poor outcomes theory”. Simply put, while the business decisions may be rational, business uncertainty means that many businesses will fail. The rewards of a few successful outcomes justify the large number of business failures. This seems to fit intuitively with what we all believe.

Behavioural Aspects of Decision-making

However, psychologists are now putting this theory to the test. They argue that it is not rational decision making in an uncertain environment but something far more basic – just bad decision-making that drives businesses to the wall. Here is where behavioural science comes into play. There is a strand of thought that argues that most of us are highly optimistic as human beings and our optimism allows for flawed decision making based on an exaggerated view of our abilities - and in the case of executives an exaggerated sense of our leadership abilities. To quote from Alan Woods, economics writer at the Australian Newspaper “ they take credit for lucky breaks such as the effect of a booming economy on profits. They see themselves not as

gamblers, which they frequently are, but as prudent and determined individuals in control of both people and events.”

As Directors and Managers we should be aware and be equipped to deal with this innate skewed optimism that tend to lead to over optimistic decision-making, which in turn drives high levels of corporate failure.

Board Dynamics are Behavioural

Directors chosen to sit on a Board would with a high degree of probability already know of each other: Maybe not formerly, but certainly through word of mouth and reputation. This is but a reflection of what appears to be the general way things are done in the commercial world and certainly relevant in a “small town environment” like Papua New Guinea. Most Boards tend to be reluctant to take on Board members “sight unseen” – that is you tend to know what you are getting.

The first important learning for a Director centres on interaction. It is how a diverse group of people with different skill sets and often-unknown personalities are brought together to deliberate on problems that beset the company. The issues centre on values; values of trust, respect, reliance, tolerance, confidence, team building, courage and leadership. Using these values as the marker, it is fair to say that the success or otherwise of the Board ultimately depends on how effectively we understand and work on these values as a team. And in an odd way just like a marriage, these values are never going to be naturally present. You have to work on them for generally cohesiveness and effective decision-making.

Avoiding “Collective Myopia”

Board education is more than just being acquainted with compliance and procedural drills, legislative requirements, and building strong and effective committees. It is also as stated about identifying the behavioural and psychological aspects of being human. As humans we all have an in built mechanism that seeks belonging and as such we tend to want be seen to fit in with a peer group. We should all recognise this behavioural trait and harness in any attempt at “group think” that may develop as a result. It really becomes a case of building a team spirit, accepting individual member human frailties, relying on each Directors core competencies and strengths and ensuring the right decision are made after an inclusive deliberation process. When we recognise the often natural but problematic tendency to forge “groupthink” behaviour, we can overcome this with honest and dynamic interaction at Board level. And if we recognise that these influences are on a Board, learning how to manage them for the benefit of all stakeholders, is a very important skill.

Effective Decision Making – Role of Chairperson

Effective decision-making is about leadership and with leadership also comes courage, a degree of sophistication and people skills. The role of the Chairperson is crucial on focusing the Board. Choosing a Chairperson is not an easy task. While many see themselves as a budding Chairperson, the required prerequisites are often lacking. A good chairperson is one who does not overtly control the discussion. A good Chair is a facilitator, much like a conductor of an orchestra. The Chair is the

collector of strands of thought that resonate through the Board and his or her role is to make some consensual position on what can be a myriad of often conflicting viewpoints. The Chairs role is also one of mentor and sounding Board to the CEO. He or she is however not the CEO and a good Chair will clearly see the delineation in the respective roles.

A number of issues arise from this – A good Chairman sticks to a Board agenda determined inconjunction beforehand with the CEO. Boards often become distracted and the discussion shifts away from the set agenda in meetings and this often creates confusion. Issues outside the set agenda should be deferred to other business, towards the end of the meeting. When there is a diversion from the Agenda it is better to seek to “park the problem” – meaning that while a subject matter remains an issue it is not of paramount importance. This means that the Board is able to quickly deal effectively with key issues and not get sidetracked by non-consequential matters.

The managing of relationships between Board members is important. An effective Board is a cohesive Board. The way to deal with a Chair who tends to drift between issues and or has strong opinions or an agenda at the start of every Agenda item is as follows:

- 1. Find fellow Directors that share your concern about the Chairs conduct of meetings. If all agree, then it may be possible to openly state the viewpoint. At times, Directors can be reticent about effectively seeking change of a fellow Member through open discussion and this is especially so in a Melanesian context.*
- 2. Agree that together you will in a non-aggressive manner correct the Chair if the Chair is drifting from the Agenda format or imposing his view before full discussion*
- 3. Remind the Chair that all views have not been canvassed and that before a position is determined all should be given an opportunity to speak*
- 4. Place Directors who share you view in direct sight of the Chair. Eye contact and demeanour are important and often subtle ingredients in effecting change and*
- 5. Finally ensure that in modifying the style of the Chair, that the board remains cohesive. It is counter-productive to change the style of the Chair but end up with an unworkable Board.*

Board Composition

Board composition is an important issue. The strength of any Board is in quickly identifying the skill sets present within the Board and identifying areas of expertise. The corollary of this is that if a Board feels that there are gaps in the composition of the Board, they should rectify either through

- Greater reliance on external advisers, accountants and lawyers and or*

- *Diversify the Board to meet the identified deficiency. This may include issues relating to gender.*

1. *Use of External Advice – Identify Core Competencies of Board Members*

There often is a tendency by Boards to “do it alone” Often members of a Board do not want to be seen as deficient in some skills and therefore pride or ego dictates that a decision is made even if all the facts are not known. Seeking external advice often can be used as a “speed bump” giving the Board time for further reflection and a confirmatory tool for decision-making. Calling for external advice is also an ideal way for a Director in seeking more time to reflect on particular issues when not necessarily convinced by the arguments, and to slow the decision making down in a non-confrontational way. Seeking independent advice in no way abrogates a Directors responsibility, but it does give the Director comfort to the tenability of a position being presented.

2. *Seeking a Board with diversified skill sets*

Dynamic Boards are Boards that have the ability to cross through barriers in regards to gender, race, colour, sexuality or life experiences. Work places like the bigger world tend to classify people into boxes and with these classifications, come stereotypes, which are used as career barriers or brakes, intentionally or unintentionally within organisations to hinder individual aspirations and career growth. As a result we tend to narrow life experiences to those people who are similar to ourselves. The results are that Boards tend to become atrophied with like-minded people making like-minded decisions. In any Board and senior management selection we should be choosing candidates not because we feel compelled to be seen to be political correct or “in tune”, but because the creation of a diversified Board is in the long term interests of developing broad based decision making in the company. – And when you think about it- in reality any company’s products or services tend to capture a wider consumer market than that represented by the collective life experiences of its Board members.

What Sought of Board Involvement do we want?

What sought of Board do we wish to be: active, passive, hands on? – A question each director has faced at sometime. The contextual framework in determining what sought of Board will centre on the

- *Current state of the organisation*
- *Effectiveness of the management team*
- *Comfortableness of Board and management in determining the boundaries of each role*

Such decisions should also be made in my view within the underlying principle that “Boards are the minds, Management are the hands” and a continual reminder that Boards are there to set direction not to micro manage the process.

Prioritisation of Issues

Once the Board is constituted and the level of engagement that Directors are comfortable with has been determined, prioritisation of key issues becomes an important agenda issue. Boards of course rely heavily on management for information including financials, cash flow and forecasts, including sensitivity analysis under various scenarios. Issues of reliability of data, quality of data presented and the amount of information presented become essential to guiding the business. Boards can be given very succinct summaries, which clearly define the pathways to follow- unfortunately Boards can also be swamped with reports that mean very little. The key here is ensuring Management delivers timely and accurate data that does not “bog down” the Board or leave the Board feeling exposed or overly questioning. In most cases it is the lack of key reliable and succinctly written financial information that is the greatest problem faced by a Director in meeting key obligations such as assessing solvency and profitability.

Strategic Planning- It Never Stops

As discussed, a Board can easily be sidetracked by lesser issues while the main game remains unsatisfactorily addressed. Similarly the easy “box ticking” issues of compliance often take precedence over the more difficult issues like formulation of strategy and policy making. Ensuring that a Board is fully conversant of a business quickly means that more time can be devoted to strategy. The need to look forward rather than back is a very useful reminder that Boards must manage the future, not reflect or get buried over the past. Looking forward is about visualising a future beyond the current mindset of the present or to use the phrase, “looking outside the square” And looking forward, also means a sound policy on issues like succession planning. When we consider the current average tenure of CEO’s and key people in organisations, the corporate emphasis is often skewed in favour of short-term results over longer term planning. Succession planning is not just about the CEO, it is also about the Chairperson and the Board. Succession planning should be an agenda item annually on every Board and a set task within the Committee structure. Selection criteria should be on tailoring the need for skill sets to meet the conditions in the future more than what is currently required.

Understanding Who Are Stakeholders Are?

Over the last decade we have seen a move to a more holistic approach to company management – I am reminded of a statement by Australian Barrister, Tony Fitzgerald QC who stated,

“we are a community, not merely a collection of self interested individuals. Justice, integrity and trust in fundamental institutions are essential social assets, and social capital is as important as economic prosperity”

While commerciality is what business is all about, the definitions of who are the stakeholders are being stretched far more so in developed economies than what we would necessarily have thought a decade ago. Stakeholders are not just shareholders and what we produce, create or service, affect much more than just the bottom line. Leading on, the move to triple line reporting and corporate social responsibility with

the need for corporations to fully flesh out their wider community responsibilities is becoming more than just lip service, it is becoming the new mantra- and how we as Directors meet this challenge, will play an important ingredient in the success of companies in the future. Thus how Boards deal with community interaction on such matters as environmental issues and occupational health and safety will more and more be seen as a litmus test as to the health or otherwise of the Board. We may even see the day where the solid legal line that Boards have responsibilities to shareholders only, shift ground to one that reflects the broad interests of stakeholder concerns.

Communication

All companies and institutions rely on communication; whether it is to shareholders, wider stakeholders, share analysts, debt providers or regulators. How effective that communication is will determine the confidence levels and environment in which the organisation operates. Communication that is honest, frank and responsive is confidence endearing. Communication is more than just being on the defensive; it is also being able to quickly move on the offensive by anticipating the issues that will become “speculative” and dealing with them quickly. The problem with most public institutions in Papua New Guinea is their inability to engage in effective on going pro-active communication. The result is a very largely suspicious group of stakeholders who view many of our organisations (State Enterprises especially) with derision.

Formation of Committees

The formation of Committees is an important function of the Board in seeking proper oversight of various aspects of the business. Well functioning Committees can act as important filters of key information back to the Board and build better decision-making at Board level. Committees drive the detail in sound internal controls, compliance and reporting. Good Audit & Remuneration committees develop sound remuneration policies, delegations of authority and review financial practices and financial controls within the organisation on an ongoing basis.

A good Risk Management Committee deals with the management of risk and succession planning. Risk definitions are becoming increasingly broad in the modern age and encompass everything from environment, occupational health, and reputation to the more mundane financial risks like interest rates and counter funding. An important outcome of major risk identification and often not developed strongly by Boards is in Disaster Recovery Plans, which should form a part of every company's fallback option if be set by disaster.

Another useful role played by Committees is for one off or ad hoc projects. This could be for a review of an investment proposal, a proposed change to the company constitution or a debt refinancing. Effective Committees have strong charters to which Members of the Committees fully understand the roles, duties and procedures to be followed. Good committee charters also spell out expectations, of individual members, the CEO and the Chairperson.

Board Review

On going Board assessment cannot be emphasised enough. Many Boards pay lip service to assessing their effectiveness and the contributions made by individual Directors. We can also see why. Unhealthy Boards that rely on the domination of a CEO or Chairman and or a Board with a clique mentality are already within their comfort zone. They are already most likely engaging in a form of “group think”. They see internal assessment as being a potential disturbance to the current order of things. A good way of looking at a Board review is to see it in the same light as SWOT analysis, the difference being that the Board is doing a Strength Weakness, Opportunity and Threat on itself as a group and at the individual Director level, not at the company level. When we talk of Directors and the Board as a whole in a review session, what we are really doing is describing weaknesses and strengths of Board Members, opportunities for improvement to the Board dynamics and threats to the Board dynamics through individual and collective Director failure.

Addressing Director Weaknesses

Many Directors when agreeing to a Board position fail to adequately address their knowledge base. Directors contemplating a Board position need to be aware of the need to be conversant in a myriad of law and regulations such as the Companies Act, Superannuation Act, Labour Laws etc. A sound working knowledge of the law, the regulatory code, the duties and responsibilities of Directors, the charters of the Committees, as well as corporate governance principles all contribute to greater performance by Directors. This is also essential considering the current drive for more independent Directors as independent Directors often lack the complete knowledge base that Executive Directors might have. Ongoing Director education programs instigated by the Board are therefore an essential ingredient in improving Board performance and leading to better outcomes in a review process. In fact an orientation program for new Directors I would argue is a minimal base entry point for Directors with recognition that Board education is ongoing. To this end we are fortunate to have a number of ongoing Director Educational Programmes in the country.

A Word on House Keeping

While Board house keeping is not a glamorous part of the function of being a Director, it never the less not only is an important discipline on the Board but also in many instances a legal requirement. It also to be effective requires a disciplined and competent Company Secretary. Boards should develop a habit of

- *Preparing agendas well before the meeting with the Chairperson playing an active role in consultation with CEO*
- *Ensuring Health and Occupational Safety is the first agenda issue discussed*
- *Developing a Board Calender*
- *Receipt of Board papers at least seven workings days before a meeting*
- *Ethical decision making - conflicts of interest identified and interests register kept*
- *Tabling of the seal register*

- *Proper maintenance of minutes including all relevant details*
- *Directors liability insurance*

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