Chartered Governance Institute

Enhancing Individual Director Accountability

April 2020

About The Chartered Governance Institute

The Chartered Governance Institute is the premier global qualifying organisation for professionals aspiring to become a Chartered Secretary and/or a Chartered Governance Professional. With over 125 years of history, we assist company secretaries, governance advisers, non-executive directors and others in the development of their skills, knowledge and experience. The Institute is an international organisation with nine local institutes in its network and 29,000 members living and working in over 80 countries. Most importantly, it brings its influence to bear on international trade bodies, governments, regulators, non-government organisations and companies to represent the views and current thinking of those involved in governance.

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Enhancing Individual Director Accountability

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Foreword

The new name for the Institute, The Chartered Governance Institute, is more than just a change of name. It represents a focus on the wider issues of governance in addition to company secretarial practice. The importance of the good governance of listed and non-listed companies, non-governmental organisations, social enterprises, public authorities and statutory bodies to the economic, social and environmental wellbeing of society has become widely recognised and accepted. At the same time, the significance and breadth of the role of governance professionals has heightened tremendously. The Institute today is a professional home, not only for Chartered Secretaries, but for the entire range of governance professionals – in fact for anyone who has an interest in the promotion of excellence in governance, wherever they work and whatever they do.

The vision of The Chartered Governance Institute is to be the leader in the practice of governance worldwide. We will be the best advocates, the best educators and the most active organisation in the promotion of good governance globally. The Institute will facilitate the international development of governance insights, practices and initiatives including occasions where the Institute will present views and ideas that vary from country to country, organisation to organisation and individual to individual. As a truly global organisation, one of The Chartered Governance Institute's strengths is to be able to communicate differences in style, circumstance and culture.

The 'Thought Leadership Committee' of the Institute is one of its platforms for the development and dissemination of ideas, insights and information on current and future trends in governance. This Paper 'Enhancing individual director accountability' is an example of the Committee's work, drawing on the experience of governance professionals across the world,

As is well known, the board establishes the governance framework of an organisation but also sets the tone. For some time, many boards of directors have largely focused their attention on structural and process matters. Arguably more important than structural or process matters are relationship and behavioural dynamics in the boardroom. The challenge for boards and management often stems from sharing power and consequently behavioural issues become critical. When loosening one's grip on control and navigating real or perceived conflict, breakdowns in how board members interact and perform can undermine the ability to govern well.

Defining directors' formal oversight duties and how these are to be met are the starting point for ensuring board members deliver on their responsibilities. Going forward, there needs to be greater recognition of the importance and value of assessing a director's effectiveness and the appropriateness of their contribution. The adoption of processes and practices that address this need in meaningful ways can go a long way to keeping relationship and behavioural matters front of mind.

This paper does not postulate that all boards exhibit the types of behaviours discussed in the following pages. As with anything there is always a spectrum and so it is incumbent on the reader to recognise and put into context what they observe. Readers are not necessarily expected to agree with all the thoughts developed and discussed in this paper. The overriding aim is to promote and encourage thought and debate and to this end new work currently underway by the Committee on the effectiveness of gender diversity will no doubt shed additional light on the subject of board behaviours and effectiveness.

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Looking beyond governance structure and process

For several decades, boards of directors have largely focused their attention on structural and process matters. As governance regimes have evolved globally, this focus has been relatively consistent across jurisdictions. While the pace of addressing important oversight issues has not exactly been done in a timely and sequential manner, common themes have echoed in the work done by leaders and legislators. These themes, in turn, have eventually found their way into the boardroom – often welcomed half-heartedly and usually reluctantly. One has to look no further than the tepid response to boardroom diversity, particularly in North America, as an example of the passivity some boards adopt in response to important issues they deem to be discretionary.

As boards have been largely fixated on how they are organised and how they do their oversight work, this has caused directors to be preoccupied with governance inputs – the myriad guidelines, regulations, best practices and other ingredients deemed relevant and often necessary to help ensure effective oversight. For the most part, many of these board governance components have come into being because they reflect legislative requirements or the results of studies, reviews or updates to the prevailing governance regime. Progress has been steady, but slow; it has hardly reflected the same rigour and commitment often applied to the pursuit of organisational results.

The importance of boardroom behaviours and culture

Arguably more important than structural or process matters are relationship and behavioural dynamics in the boardroom. While hard data on board culture and behaviour is elusive due to limited access to boardrooms and the reliance on anecdotal evidence, it is not a stretch to suggest that without highly functional boardroom relationships – among board members and with management – boards cannot hope to govern well by relying solely on the other two legs of the governance stool: behaviours and culture.

The challenges that boards and management often encounter when sharing power, loosening their grip on control and navigating real or perceived conflict can undermine their ability to govern well, because the essential need for trust and confidence in each other can be compromised and, unfortunately, tolerated.

Many boards simply ignore the relationship factor, recognising rather passively that they are often ill-equipped to do otherwise. The starting point for calling out inappropriate behaviour or addressing gaps in the trust and confidence between boards and the management groups they oversee is ill-defined and stymied by flat-footed responses. As a result, a propensity to focus on the bottom line often results in short shrift being given to boardroom behaviour.

This reality is due, at least in part, to the prevailing culture in Western and other similar jurisdictions where individualism trumps collective engagement. The lack of explicit attention given and accountability applied to board culture means boardroom dynamics evolve haphazardly. Unlike role mandates and oversight processes, boardroom culture is rarely, if ever, explicitly defined. Rather than choosing and fostering a preferred boardroom culture, the relationship dynamic reflects the varied and often conflicting assumptions, expectations and experience that individual board members bring with them to their board assignments (along with their individualistic tendencies and inability to adapt to group work).

In Western countries, in particular, attention is and has been given to corporate teamwork – this derives from a recognition that static hierarchical accountability structures undermine the true potential of the collective input of employees and partners. It is also a counter-response to how our culture instils a strong sense of self-sufficiency, individualism and self-actualisation, fostering an internal competitiveness that politicises the workplace. Those at the top of these power structures then find themselves in the boardroom where this dynamic continues to play out among directors and with management. The attributes that are hardwired into the psyches of leaders in free market economies are hardly the basis for effective group work and decision-making. Bona fide teamwork that reflects a highly collaborative and interdependent approach to the workplace is highly elusive and rarely, if ever, takes up residence in boardrooms.

While boardrooms may be cordial and respectful, this politeness is often little more than a thin veneer. Rather than challenging inappropriate or unconstructive behaviour, board members often acquiesce and passively accept this negative dynamic, feeling it equally inappropriate to challenge their peers. As much as there may be strong agreement of the need for candid engagement and interaction, board members are often reticent to raise or act on concerns.

Boardroom dysfunction and the root cause

The root cause of boardroom dysfunction, then, is the lack of recognition of and attention given to the role relationships and culture play in governing well. There is too often a lack of meaningful accountability for board and individual director performance and a lack of any real impetus to challenge and change the status quo. To do so requires humility in place of hubris and deference instead of personal preference.

With the focus on directors' skills, knowledge and experience in the nominations process, it is clear little consideration is ever given to nominee behaviours and their individual ability to contribute in meaningful and constructive ways in a group or team environment. As a result, boards get what they ask for: highly successful individuals who may or may not have the temperament to function well in the boardroom. Inappropriate behaviour is often deemed to be linked to personalities that are controlling, overbearing and verging on bullying. Just as problematic are temperaments where there is a lack of courage, commitment or candour to call out inappropriate behaviour.

In assessing board performance, the onus is often focused on governance inputs. The focus of such reviews tends to be on structural matters (that is, how the board is organised) and process considerations (for example, how the board delivers on its oversight responsibilities). Even with a focus on boardroom culture and behaviours within the collective of individual directors, there is typically a lack of direct personal accountability for how individuals conduct themselves and contribute to the work of the board. As such, many organisations remain overly reliant on director terms, acquiescing to the fact that less than ideal behaviour will have to be tolerated or accommodated for a time.

A double standard in the boardroom

If a function of leadership is to model the kind of behaviour expected of others, it is problematic when management decries the conduct of board members and there is no mechanism or accountability for directors to take steps to align their conduct with an organisation's values and other appropriate behaviours.

The upshot of all this is often a double standard between board members and management whereby the latter is held to account and the former is tolerated when assumed standards of performance are not met.

Breaches in appropriate boardroom behaviour go beyond mere slip-ups to blatant examples of poor performance and conduct (for example, not coming to meetings prepared to contribute, arriving late and leaving meetings early, demonstrating a lack of respect for others' views). Behaviour unbecoming of a director is another area of concern (for example, refusing to acknowledge that policies, procedures and standards are applicable; impatience with certain agenda items deemed unimportant or which result in thorough discussion; passivity, etc.).

There are examples of even more egregious conduct. Stories include having to schedule meetings to accommodate poor director behaviour, and interactions with other directors or management noted for their rudeness, bullying and blaming.

The root cause would appear to be arrogance and pride that, in turn, manifest themselves in a lack of respect and, in some cases, a downright lack of personal responsibility. None of these behaviours would be acceptable in a CEO or other ED.

The essence of the problem is the inability or unwillingness of many board members to deliver fully on their duties. The obligations required of every director are relatively simple. Board members are expected to prepare for meetings, attend meetings, actively engage during meetings, contribute directly to the board's decision-making process and, ultimately, to support and take responsibility for the decisions once made. These obligations are the foundation of each member's contribution to the work of the board and determine how each director is to apply the skill, knowledge and experience for which they were recruited to the board.

But once they find themselves around the boardroom table, the commitment to fulfilling these obligations is often soft. Other demands, conflicting schedules and priority given to other commitments can easily, if not unintentionally, impact on their board obligations.

In workshops facilitate with boards the following scenario provides a useful lesson. Your CEO informs the chair a week or more before the board meeting that the pre-read materials cannot be provided on time, if at all. Further, the CEO's attendance is uncertain. At best, the CEO will attend the meeting, but because of other demands and life's distractions, there should be no surprise if they are not as engaged or responsive as the board expects. Following the meeting, the CEO hopes the board will understand if they are not able to fully support the decisions made given conflicting views on what the strategy should be and how results should be assessed, measured and compensated. The response to such a scenario is always unanimous: the CEO must go.

As abhorrent as it would be for a CEO to conduct themselves in this manner, boards do little more than breathe a sigh of frustration when board members do the same. So much for modelling leadership expectations.

A lack of meaningful director accountability

The adoption of a process to assess individual director performance and contribution has received slow uptake on the part of board members generally, despite similar processes being the norm for management. This reluctance is inconsistent with the level of accountability the board should expect of management in terms of achieving organisational results, providing ethical leadership and the like. However, there is rarely a formal argument against processes where individual director performance is addressed. Rather, it is often just a choice whereby directors arbitrarily refuse to subject themselves to such practices.

Sometimes, the perceived risk that director assessments may negatively impact board unity is often offered as the reason for not conducting such evaluations, as well as it could reflect poorly that those directors were selected in the first place. This argument is largely speculative and often without merit. Such logic infers that inappropriate director performance or behaviour should not be addressed in a meaningful way. Where this is not the case, it is often left up to the board chair to challenge those offending board members as situations arise. Rather than policy and practice driving the process, board member performance is often only subjected to casual, reluctant and inconsistent consideration. The response is typically arbitrary, reactive, situational and unpredictable.

From a leadership perspective, directors should be proactive in promoting and welcoming the same kind of rigorous performance evaluation they expect of their management leaders. But to do so is often seen as demeaning to boardroom leaders and somehow inappropriate given their stature and past achievements.

Finally, board members seem oblivious to how demoralising and demotivating inappropriate behaviour can be from the perspective of management. This lack of boardroom accountability sends a dangerous message to management and serves to undermine the board's authority by eroding the respect and confidence that management should have for directors.

Recognition of governance standards and expectations

Increasingly, there is recognition in emerging governance standards that boardroom behaviour is or should be a priority for boards to address. There are references in governance guidelines and directives, and from commentators, that directors have an important role to play with respect to organisational culture, as part of their formal duties. In turn, director behaviours are fundamental to establishing the appropriate cultural norms.

The Financial Reporting Council (United Kingdom), in its *Guidance on Board Effectiveness* (2018), made the following references with respect to this topic on overall board effectiveness:

- Directors are expected to act in a manner consistent with their statutory duties, to uphold the highest standards of integrity and to support the chair in instilling the appropriate values, behaviours and culture in the boardroom and beyond.
- Directors can reinforce values through their own behaviour and decisions. To do this effectively, executive and non-executive directors may need to increase their visibility.

In Australia, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Final Report signalled that there are significant risks around poor corporate culture. The Commission recommended the regulator Australian Prudential Regulation Authority (APRA) build a supervisory program focused on building culture that will mitigate the risk of misconduct. The Australian Securities and Investments Commission (ASIC) is also looking closely at corporate culture, post the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Ultimately, accountability for corporate culture is within the purview of an organisation's board of directors. As stated by the Governance Institute of Australia and others in *Managing Culture – A Good Practice Guide* (2017):

> The board is responsible for setting the tone from the top. The board should set the ethical foundations of the organisation through the ethical framework.

Given the resistance to allowing themselves to be held accountable for the tone they set as board members, it is important to avoid the inherent irony that would result if the board became increasingly demanding in their oversight of organisational leadership and their behaviours, while steering clear of setting complementary expectations of their own boardroom behaviours.

To successfully develop a culture of openness and transparency, the behaviours of directors need to be commensurate with the stated values and principles of the organisation. This can only be facilitated by robust and open discussion and debate, regular assessment and accountability.

As former US Securities Exchange Commission Chair, Mary Jo White, noted:

> Ensuring the right 'tone at the top' for a company is a critical responsibility for each director and the board collectively. Setting the standard in the boardroom that good governance and rigorous compliance are essential goes a long way in engendering a strong corporate culture throughout an organisation.

Regulators are of the view that ethics and honesty can become core corporate values only when directors and senior executives embrace them. But appropriate behaviour might also go beyond ethical conduct to also include interpersonal considerations.

The imperative going forward

Defining directors' formal oversight duties and how these are to be met form the starting point for ensuring board members deliver on their responsibilities. Presently, there is insufficient attention given to holding individual directors accountable for their performance in meaningful ways. Going forward, there needs to be greater recognition of the importance and value of assessing a director's effectiveness and the appropriateness of their contribution through the adoption of processes and practices that address this need in meaningful ways.

Poor behaviour needs to be 'called out' when it manifests itself, ideally by the chair but, failing them, anyone who witnesses it. Leaving it unaddressed even once creates a precedent and a behavioural norm for the individual in question, and for others who may take their lead from the individual.

Complaints against any director should be reported to the full board and handled by a set procedure.

Directors should self-police and either defer to the norms that are purposefully and explicitly identified and adopted or remove themselves from the board if they are uneasy with or not supportive of the chosen culture.

Diversity in any form, be it gender, age, background, race, whatever, goes beyond expanding board capability. It also serves as a proactive preventative measure from allowing a particular adverse culture becoming ingrained and acceptable.

The problem begins with the appointment of directors. Additionally, rigour should be applied with the recruitment process, including a step whereby prospective directors participate in an assessment of personality and character traits that are aligned with the board's chosen culture, values and behaviours.

To encourage accountability, the disclosure of directors' qualifications should include more than an abbreviated curriculum vitae. Rather, such disclosure should also explain the particular qualities and capabilities for which board members have been nominated or appointed and how they intend to contribute to the board.

Directors should meet regularly outside the formal setting of a boardroom, providing an opportunity to raise matters in a lower key manner than may be possible at board meetings.

Independent directors should be encouraged and expected to meet a wide cross-section of their organisation's management and staff, both at work and at more social occasions. Remoteness and aloofness are undesirable.

The chair is a key figure in all this, even though it may be unfair to saddle this role with the duty of monitoring other people's conduct and behaviour. At the same time, accountability for boardroom culture should be explicitly assigned. This accountability should be supported by the company secretary or a respected senior director, who are tasked with reminding the chair of their obligation to ensure the board sets the ethical foundation of the business.

The chair should not allow directors to fence-sit, especially on significant issues. Each board member should explicitly be either for or against a given course of action.

All policies and procedures, especially any code of conduct, must apply equally to directors as well to any member of management or the broader employee group.

Finally, while there are processes and tools other than board-related evaluations that are helpful in instilling greater accountability, more proactive adoption of individual director assessment facilitated by objective third parties will help focus attention on the need for board members to deliver on their obligations. The third party should ideally be proposed by the company secretary and then approved by the full board. The process used should adopt maximum rigour, including observation at board and committee meetings, and interviews with each board member, as well as each member of management who has regular interaction with the board. To preserve independence and objectivity, no assessor should carry out more than two successive assessments.

The assessor should be expected to identify areas of strength and also opportunities for improvement for each director. Finally, a process needs to be established to include monitoring and assessment on progress against the areas for improvement. The findings of the review should be discussed with each director, as well as the chair. An overview report should be prepared for consideration by the governance committee of the board, prior to formal reporting to the whole board.

Conclusion

The importance of boardroom behaviour and culture cannot be overstated. Boards cannot hope to govern optimally by relying on process alone and so must focus on a broader range of inputs that determine board effectiveness. Too often however, the lack of specific attention given to board behaviour and culture means that boardroom dynamics can evolve haphazardly. To address this, directors need to add their own board's culture to the mix of what they focus on.

As with anything that is important, accountability goes to the heart of fostering healthy boardroom behaviours and culture. In this regard, accountability must go beyond skills, knowledge and experience and include attention to building an effective team. To develop a highly functioning team environment, necessary for an optimal board, adoption of processes to address individual director performance and contribution are critical. And from a leadership perspective, directors should be proactive in promoting and welcoming the same kind of rigorous performance evaluation they expect of management leaders.

The Chartered Governance Institute sees healthy boardroom behaviour and culture as one of many key features of a high functioning board. Members of the Institute are in the boardroom every day and are privy to observing some of the most effective boards across the globe. That is why the Institute has published this discussion paper. When you see the very best in board performance you want to spread the news and you want to provide an insight that all governance professionals can use themselves.

For over 125 years The Chartered Governance Institute has educated the very best company secretaries and governance professionals. The Institute's members become Chartered Secretaries and Chartered Governance Professionals and can bring their depth of knowledge and experience to the attention of all of those involved in the governance of their organisation.

The Institute is pleased it is in a position to make a positive contribution to boardroom effectiveness through this paper and it will continue to do so into the future.

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