



Corporate governance – is DIY really effective?

Domini Stuart outlines some of the pitfalls companies may face in doing an internal assessment of their corporate governance systems. If you do decide to self assess, there are practical questions you should ask to make this process more structured and productive.

On 15 March 2001, the HIH group collapsed with a deficiency of around \$5.3 billion. This was Australia's largest corporate failure, and Phillip Lipton, Associate Professor of Corporate Law at RMIT, believes that the ensuing Royal Commission report provides a very useful case study in corporate governance.

“This is particularly so because HIH was not an unusual case of major fraud or embezzlement,” he says in an article published in Keeping Good Companies magazine. “The failures identified by Commissioner Owen were, by and large, failures stemming from mismanagement.”

Just over a year after the crash, the ASX formed a Corporate Governance Council. The Council's brief was to develop and deliver an industry-wide, supportable and supported framework – a practical guide for listed companies, their investors, the wider market and the Australian community. The result was a set of 10 ASX Essential Corporate Governance Principles including, at number eight, a recommendation that boards ‘fairly review and actively encourage enhanced board and management effectiveness’.

These best practice recommendations are not compulsory, though a company deciding to opt out is obliged to explain why. This “if not, why not?” obligation is the closest we have to legislation relating to corporate governance and companies seem to be taking it seriously. A KPMG survey of the uptake of the ASX guidelines in 2004 found that around 30 per cent of the companies surveyed had undertaken a board review. An updated survey in 2005 put the figure at 90 per cent. However, there is no evidence that this leap is due entirely to a growing commitment to improvement. A

cynic might argue that some boards find it easier to go through the motions of a review than to explain their decision not to.

Lipton believes that many directors see the current emphasis on corporate governance as misconceived and ultimately counterproductive – an attitude loosely linked to age. While many younger directors take assessment for granted, older members may have served on boards for many years without being subject to appraisal of any kind. As a result, they are more inclined to see any kind of review as undermining their ability and authority.

Geoffrey Kiel, Professor of Management at the University of Queensland and Chairman management consultancy Competitive Dynamics Pty Ltd, argues that every manager recognises the need for continual improvement, and that directors should feel the same. “Properly conducted reviews can bring about greater transparency, enhanced leadership and a better relationship with management,” he says. “This benefits the organisation as a whole.”

Nevertheless, with the average age of board members standing at 56, it is clear that the matter may need to be handled with sensitivity.

An evolutionary process

For some, sensitivity might mean keeping the review in house rather than bringing in a professional from outside the organisation.

“When I started 7 years ago, the reaction to any kind of evaluation was generally ‘Oh God!’,” says Deborah Smithers, national leader of KPMG’s Board Advisory Services. “Now it’s considered the norm by many boards. But the process needs to be seen as an evolution. You wouldn’t try to run a marathon without training first and, in the same way, a board may need to move into assessment quite gently.

“If a board feels more comfortable starting out with self assessment rather than assessment by an outside agency, this is perfectly appropriate. As my trainer used to say, any movement is better than no movement.

“It’s a tough role being a board member,” she continues. “It’s a part time position yet you have ultimate responsibility and liability. It’s also a very complex role. A key issue is getting the right information from management – but where is the line over which the board does not tread?”

“As a chairman, you need to know that, say, 10 directors have the complement of skills to ensure strategic outcome. Technical, legal, accounting – they’re all needed, but they won’t all be found in one person.

“Each member must recognise their strengths and weaknesses, and know what they need to do to be effective. Do I attend meetings? Do I challenge? Do I ask questions? Do I read board papers? Do I mentor management? Do I understand the roles of board and management? By bringing attention to these kinds of questions, a review can help to clarify what constitutes responsible governance and the value that members brings

to the board. It can also provide an opportunity for directors to enhance their own particular skills.”

A self assessment benchmark

For Bayside Health, self assessment was not a soft option.

A large and complex organisation, Bayside Health has more than 4000 staff and an annual budget of \$0.5 billion. However, Executive Officer Alison Duncan-Marr is confident that the Board is capable of rigorous self-evaluation.

“Perhaps it has something to do with the kinds of people who are willing to commit themselves to service on a public sector board for which they are barely remunerated but, in my experience, our board members are genuinely committed to improving their individual contribution and to enhancing the performance of the board as a whole,” she says. “They have been willing to devote time to learning more about the way effective boards work and to working through the evaluation process with an open mind. Bayside Health may have been extraordinarily lucky with the calibre of the people who have been appointed to the board, but I suspect that the tendency for the good of the organisation to be paramount in the minds of board members is a characteristic of public sector boards.”

While Bayside Health’s model of self-assessment is something of a benchmark, it evolved from a process developed originally with the help of a consultant.

“The Board was quite new when she was engaged and we did find it useful to have someone with experience facilitating the process at that early stage,” says Duncan-Marr. “She had a range of evaluation tools that were easy to tailor to our needs. And another benefit was her impartiality, which I think was a factor in encouraging Board members and members of management to comment frankly on their experience of the Board and its performance in the first year.

“However, by the end of that year, the Board decided there was sufficient trust and confidence among the members, and in its relationship with management, to be able to evaluate its performance without external assistance.”

A singular board

For 21 years, CanTeen has been supporting, developing and empowering young people living with cancer from all around Australia. The organisation is committed to giving a voice to its Members - young people living with cancer – and, as a result, their board structure is unique.

“We have five current CanTeen Member Directors and four Associate Directors – volunteers who bring relevant expertise to the Board,” says President David Gregory. “Our Constitution requires that our President and Vice-President are CanTeen Members, and that all votes of the Board include a majority of Member votes.”

The board's annual assessment incorporates feedback from the division committees and Members, division staff, the national management team, the management advisory council and the CEO as well as the directors themselves.

“CanTeen is generally a very positive organisation, and for that reason, it can be difficult for those in the organisation to give and receive constructive or negative feedback,” says Gregory. “This is something that we as a board are aware of, and I believe that we all understand that it's more important to be open and honest, and to give constructive feedback when it's due, than to avoid the issues. We're only going to grow and develop if we're aware of our mistakes and can learn from them.”

Doing it yourself

For companies who decide to go it alone, *Board, Director and CEO Evaluation* is one book which covers all essential ground. Authors Professor Kiel, Gavin Nicholson and Mary Anne Barclay believe that there seven questions are fundamental to any review.

1. What are the objectives?
2. Who will be evaluated?
3. What will be evaluated?
4. Who will be asked?
5. What techniques will be used?
6. Who will do the evaluation?
7. What will be done with the results?

Once this framework has been established, the evaluation itself can take one of several forms.

At its simplest, it might resemble a performance review – a series of one-on-one interviews by the chairman. The chairman might also ask for feedback on his or her own performance before leading a group discussion of the findings.

The board might also want to design a questionnaire for each director to complete which the chairman would present back to the board. The questionnaire might include a peer group review, where each director is invited to provide feedback on fellow board members – though this needs to be handled with particular sensitivity.

Finally, there must be an action plan.

“This is often the thing that's missing,” says Warren Tapp, Managing Director of Directors Australia Pty Ltd. “But an assessment is worthless if it is an end in itself – it must be a process of continual improvement.”

Polishing the halo

The methodology is simple enough and, whether a review is internal or external, the basic tools are the same. But what of the outcome? Is it really possible for a company to be as rigorous in its assessment as an independent professional?

“If a board chooses self assessment because it’s less threatening, this is a danger in itself,” says Tapp. “It could just be the easy way for them to look as though they’re doing something.”

He is also concerned about what he describes as the halo effect.

“It can be difficult reviewing yourself and people you have a relationship with. There’s a real temptation to agree that everyone is doing a pretty good job and that there aren’t any problems.

“Independent reviews tend to be more objective and forthright – we can say things most people would find difficult. For instance, if one person is causing problems, it will come out in the review, but it’s not always easy for a self-assessing board to deal with that. We’ve been approached by boards who say ‘We want you to tell us that Fred Bloggs isn’t any good’”.

Tapp knows of boards capable of robust self review, but believes that, for some, this is an impossibility.

“In order to be successful, you must be skilled at giving constructive criticism,” he says. “This is generally easier for board members who were once CEOs – they’re used to doing performance reviews, and also to copping it on the chin themselves. Where a chairman doesn’t have the skills or personality to raise issues constructively and with sensitivity, the result can be deep offence, hurt and upset.”

He also believes that the longer a board has been together, the more rigorous the self-assessment needs to be. “I’ve seen some boards with such a strong sense of collegiality that you almost feel they’ve raised the drawbridge, adopting an attitude that says ‘we’re making the tough decisions, it’s us versus the rest of the company’.”

Alan Cameron, Chairman of Cameron Ralph Pty Ltd agrees that self assessment is less likely to identify problems that directors have difficulty discussing, and especially issues to do with relationships. “Even if they are identified, there’s less likely to be any effective action,” he says. “You’re also much less likely to find out what senior staff are thinking about the board.

“An external board performance assessment shifts the improvement of corporate governance on to firm analytic footings. This can help to improve the performance of boards in a number of ways: by mapping governance practices and performance against a set of measurable standards; by establishing a benchmark for future assessments; by identifying areas for continuing improvement; and, in time, by comparing practices with those of peers.”

A move out of the boardroom

Research suggests that in-house reviews are favoured by around 80 per cent of the Top 50 ASX listed companies, though Cameron believes that the actual figures may be misleading. “About half of those who claim to use self assessment say that they use

an external facilitator of that process – and that’s pretty close to independent assessment,” he says.

This view supports the claim that many outside assessors are willing to work with a board to combine the two approaches. KPMG, for example, offer everything from a simple on-line self-assessment tool with automatic reporting to an in-depth process of interviews, discussions and workshops.

Warren Tapp believes a move towards outside assessment is inevitable.

“Some companies are coming to see the limitations of internal reviews, like one that called us in recently because they had recognised they were just telling themselves the same thing every year. And publicly-listed companies are under increasing pressure to be transparent. A lot of them feel that an external review is telling the world that they have nothing to hide.”

Personal recommendation

The number of external agencies offering help with corporate governance is keeping pace with demand. Most major accounting firms and a number of law firms now offer an assessment service, as well as companies working specifically within this area. Reports suggest that the majority are chosen as a result of personal recommendation.

While external reviews can cost anything from a few thousand dollars to something close to six figures, there is a feeling amongst consultants that saving money isn’t a major motivator for those who choose an internal review. Neither is the amount of time and effort required as, in either case, this will be governed by the depth of the assessment. And, while there is no hard and fast rule as to frequency, most consultants recommend an annual review of some kind. “I think there’s a need for some kind of reflection every year, but this doesn’t necessarily mean an intensive annual review,” says Deborah Smithers. “You might have an external review one year and an internal review the next.”

“Like almost any team, most boards – even those in charge of successful companies – can improve the quality and effectiveness of their performance,” says Alan Cameron. “The role of a review is to see if the board is adding value...and generally to help them improve what they do. In today’s competitive environment, good corporate governance is a key strategic advantage.”

Breakout box

The darker side of mateship

Andrew Kakabadse is currently working with governments around the world, conducting a major international study of boardroom effectiveness and governance practice. As Professor of International Management Development at Cranfield School of Management, former Visiting Professor at the Australian National University,

Canberra and Visiting Fellow at Babson College, Boston, he is perfectly placed to compare Australian boards with their UK and US counterparts.

“Australia is one of the better countries at utilising non-executive directors – and they are diligent in searching for non-executive directors that bring the right skills and experience to the board,” he says. “They also take corporate governance far more seriously than most English and Americans, who tend to dismiss it as an irritation and a waste of time.

“We identified some of the best practices in the world in Australia, along with a number of outstanding chairmen and boards with a very sound and robust dialogue.

“However, Australian Chairmen repeatedly talk about the team and working as a team – and this is very unusual. By nature, a board is a collection of individuals whose job is, in a sense, to police the organisation. We were quite concerned by the concept of ‘team’. Our emerging conclusion is that the word is almost always used as an alternative to surfacing sensitive issues.

“In this context, mateship is not a healthy phenomenon,” he continues. “Loyalty to the team carries the implication of resisting and repelling outside comment and criticism. That’s not the purpose of a board – it is not a positive sign.”

Kakabadse points out that the word ‘governance’ is derived from an Ancient Greek word meaning ‘to steer a boat or ship in stormy waters’ – a perfect description of the chairman’s role.

“Being chairman of a board takes the wit and guile and disciplines of seamanship,” he says. “Australians are good with the disciplines – the skills and procedures – but not so good with robustness of leadership and conversation. They don’t always have the guts to raise difficult issues – perhaps because, in a relatively small community, they run the risk of being scapegoated, and suffering in their career.”

As former BHP Billiton chairman Paul Anderson told the Sunday Age, “In Australia you've got an awful lot of boards where people serve on two or three boards with the same people, and they know each other, and it's a little cosy.”

Kakabadse perceives Australia as lying almost exactly half way between England’s Westminster system and the US presidential system, perhaps leaning slightly towards the presidential. “Culturally and politically, the psyche of the nation is very American, which is not always a good thing. Much of the literature comes straight out of the US and, ironically, many Australian professionals are now favouring the American Sarbanes-Oxley statute even though Americans themselves are openly hostile to the legislation.”

The Sarbanes-Oxley statute was introduced in 2002 with the aim of improving the accountability of managers to shareholders, and rebuilding confidence shattered by scandals at Enron, WorldCom and other major corporations. However, many of America's business leaders are deeply dissatisfied with a law which they claim addresses symptoms rather than causes.

The law's most controversial provision makes managers responsible for maintaining an 'adequate internal control structure and procedures for financial reporting' and demands that auditors 'attest' to the management's assessment of these controls.

Kakabadse agrees with detractors that this is, in effect, signing away transparency and honesty. "Those doing the signing are also those most likely to be doing any transgressing – the law could actually be a means to hiding even greater corruption," he says. "I would like to see the Australians putting up more of a challenge. While companies doing business out of America need to comply, those within Australia don't. They don't seem to know how to rebuff it – but I can't see how it can do Australians any good.

"Australians have a lot to offer – but they still seem to be subject to a kind of corporate cultural cringe. It would be good to see them become a little less brash, but with a more deeply-felt self-confidence."

Case Study: Bayside Health

The first evaluation of the Board and its committees took place in the second half of 2001, facilitated by an external consultant with experience in the evaluation of non-profit boards.

Questionnaires were circulated to Board members and senior management for feedback on the Board's performance across a range of responsibilities, and each section offered an opportunity for suggestions on how the Board might improve its performance.

Clinical governance evaluation

The Bayside Health Board identified four principles of good clinical governance and developed a clear clinical governance role description and a self-evaluation instrument based on the principles.

Evaluation of instrumental processes

Board members use a five-point scale to rate the effectiveness of mechanisms used to fulfil responsibilities arising from decisions or commitment, and to comment on ways in which performance could improve.

Evaluation of meetings and processes

Every quarter, a different Board member observes and records comments about the meeting, assessing the quality of the papers and presentations from management; the extent to which the meeting kept to time; the clarity of the decisions made; the quality of the interactions among Board members and between members and management; and the balance between the time spent on discussion of strategic issues and discussion of operational matters.

A short time is set aside at the end of the meeting for preliminary feedback, and an evaluation report is prepared for further discussion at the next Board meeting.

Evaluation of members' contributions

The Board members and the Chief Executive rate the contribution of every member of the Board in each of the thirteen areas of skill that health service Boards are expected to include. Board members use a scale ranging from zero (“no contribution”) to three (“significant contribution”) to rate each other and themselves.

The Board Secretary de-identifies the completed spreadsheets and forwards them to the Board Chair who produces a summary chart. There is no expectation that individual Board members will contribute significantly in every skill area. However, the process enables the Board to identify gaps in its mix of skills.



Developed by Competitive Dynamics and reprinted from “Boards That Work” (McGrawHill, 2003), the Corporate Government Charter highlights four major components of an effective program of corporate governance.

- **Defining Governance Roles:** delineating the role of the board and key players in the governance system
- **Improving Board Processes:** enhancing the administrative functions and processes of the board
- **Key Board Functions:** elaborating the critical activities that a board performs and defining performance expectations
- **Continuing Improvement:** the procedures and processes which lay the foundation for continuing improvement in corporate governance