

# BOARD OF DIRECTORS

4/1/2015

Lecture 3 Part 1

# INTRODUCTION

- The board of directors is the fulcrum of corporate governance: the critical nexus in which the fortunes of the company are decided.
- At the beginning of a company's life the board often represents the DNA from which the company will grow and succeed.
- In maturity the board represents the source of values and objectives that will sustain the vigor of the company.
- The board is therefore responsible internally for the leadership and guidance of the corporate entity.
- However, the board has a wider set of external responsibilities, **firstly** towards investors, '**The board is the link between the shareholders of the firm and the managers entrusted with undertaking the day-to-day operations of the organisation**' (Stiles and Taylor 2001: 4);
- Secondly towards the wider stakeholders who are the essential partners of the entity.

# WHAT DO BOARDS DO?

3

- According to Carter and Lorsch (2004: 67)
  - “Boards are essentially involved in three distinct activities: monitoring the company and management performance; making major decisions; and offering advice and counsel to management, especially the CEO”.
- Therefore the key roles of the board can be conceived as:
  - **Control**: Monitoring the management of the company and ensuring accountability.
  - **Strategy**: Approving and monitoring the strategic direction of the company.
  - **Counsel**: Providing advice and counsel to the company executives on critical matters.
  - **Institutional**: Building institutional relationships with investors, stakeholders and the community (Zahra and Pearce 1989; Johnson et al. 1996; Daily et al. 2003).

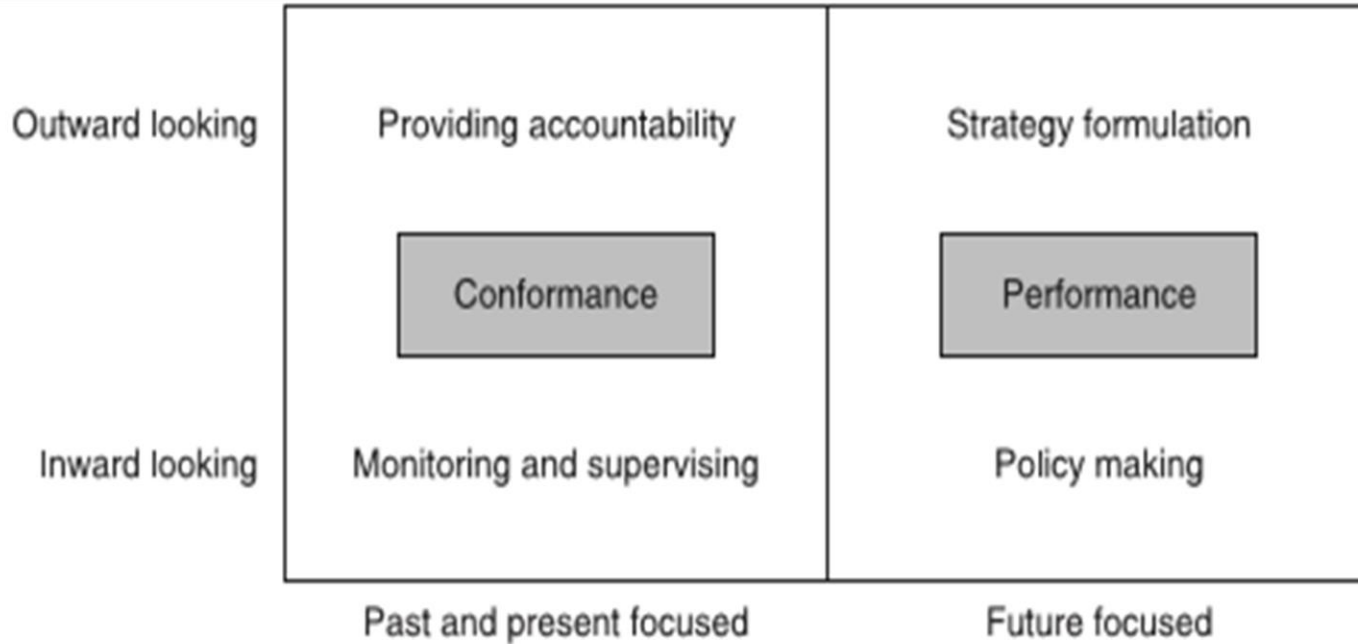


Figure 2.1 Framework analysing board activities.

Source: Hilmer, F. and Tricker, R.I. (1991), *An Effective Board, Company Director's Manual*, Sydney: Athol Yeomans, Pearson/Prentice Hall.

# A DISCUSSION ABOUT BOARD OF DIRECTOR

- Legally, the board is the highest authority in the company, the ‘fountain of power,’ yet top management naturally tends to exercise that power ... Board members are expected to provide critical judgement on management performance – which requires an in-depth knowledge of, and intimacy with the affairs of the corporation – and at the same time to assure that this judgement is independent – which requires detachment and distance ... The working style of the board must build its collective strength: the board needs the trusting familiarity of a close-knit group, yet members must be independent personalities who can resist ‘groupthink’ and raise critical questions of colleagues. (Demb and Neubauer 1992: 13–16)

# Directors Duty

6

- In the UK directors' duties are largely embedded in the common law established over time, with some statutory interpretative overlay. The Company Law Reform Bill (2005)

# Directors Duty

7

1. To act within the powers conferred;
2. To promote the success of the company for the benefit of its members. Directors must have regard to the long term and wider factors such as relationships with employees, suppliers, customers and the impact of the company's operations on the community and environment;
3. To exercise independent judgement;
4. To exercise reasonable care, skill and diligence;
5. To avoid conflicts of interest;

# Directors Duty

8

6. Not to accept benefits from third parties;
  7. To declare an interest in a proposed transaction with the company.
- Under this legislation shareholders will enjoy a statutory right to pursue a claim on behalf of the company against a director for negligence, default, breach of duty or breach of trust. (Linklaters 2005: 2).



# Board Duties and Functions (OECD)

- The OECD Principles of Corporate Governance (2004) specifies the board's key functions as:
  1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives, monitoring and implementation and corporate performance; and overseeing major capital expenditure, acquisitions and other divestitures.
  2. Monitoring the effectiveness of the company's governance practices and making changes as needed.
  3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.

# Board Duties and Functions

10

4. Aligning key executives and board remuneration with the longer term interests of the company and its shareholders.
5. Ensuring a formal and transparent board nomination and election process.
6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse of related party transactions.
7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit and appropriate systems of control are in place, in particular systems for risk management, financial and operational control, and compliance with the law and relevant standards.
8. Overseeing the process of disclosure and communications.

# The American Law Institute's (1994) Model Board Duties and Functions

11

- The American Law Institute's (1994) model of directors' duties indicates an evaluating and reviewing role, with the duty to appoint the senior executives who are responsible for managing the business, and then to review their progress:

# The American Law Institute's (1994) Model Board Duties and Functions

1. Select, regularly evaluate, fix the compensation of, and, where appropriate, replace the principal senior executives;
2. Oversee the conduct of the corporation's business to evaluate whether the business is being properly managed;
3. Review, and, where appropriate, approve the corporation's financial objectives and major corporate plans and actions;
4. Review and, where appropriate, approve major changes in, and determinations of other major questions of choice respecting the appropriate auditing and accounting principles and practices to be used in the preparation of the corporation's financial statements; and
5. Perform such other functions as are prescribed by law, or assigned to the board under a standard of the corporation.

# The Australian Stock Exchange (ASX)

13

- The Australian Stock Exchange (ASX) Principles of Good Corporate Governance (2003: 16) adopts the Cadbury formulation obliging companies to comply or explain non-compliance, and requires listed companies to ‘recognize and publish the respective roles and responsibilities of board and management’.
- The principles do not specify an exact distribution of functions, but suggest the board will usually be responsible for:

# The Australian Stock Exchange (ASX)

14

1. Oversight of the company including its control and accountability systems;
2. Appointing or removing the chief executive;
3. Ratifying the appointment and removal of the chief financial officer and the company secretary;
4. Input and final approval of management's development of corporate strategy and performance objectives;
5. Reviewing and ratifying systems of risk management and internal compliance and control, codes of conduct and legal compliance;
6. Monitoring senior management's performance and implementation strategy;
7. Approving and monitoring the progress of major capital expenditure, capital management, and acquisition and divestitures; and
8. Approving and monitoring financial and other reporting.

# BOARD AND CEO RELATIONSHIP

15

- Though the various national and international corporate governance principles on the role of the board are a helpful guide to the essential duties of boards, they do not explain how the relationship between the CEO and the board is to be arranged and managed.
- This is of critical importance since this relationship has often proved an uneasy frontier in which boards have often consciously or unconsciously crossed into (often unhelpful) involvement in the operational detail of management.
- More worryingly, CEOs particularly in the United States, but occasionally in all jurisdictions, have been known to usurp the powers of the board of directors, leaving an enfeebled board with an entirely nominal role.

# BOARD AND CEO RELATIONSHIP

16

- In appointing the Board, shareholders vest the management and control of the business and affairs of the Group in the Board.
- The Board has reserved some matters to itself for decision and, save for those matters, has delegated authority for all other matters to the CEO.



# POWERS RESERVED FOR THE BOARD

17

1. Appointments to the position of CEO and approval of the appointment of executives reporting to the CEO.
2. Approval of strategy and annual budgets.
3. Determination of capital and non-capital items in accordance with the Approvals Framework.
4. Determinations and adoption of documents (including the publication of reports and statements to shareholders) that are required by the Group's constitutional documents, by statute or by other external regulation.

# Delegation of Powers

18

- Beyond the items above the Board delegates to the CEO all authority to achieve the Corporate Objective.
- The CEO is free to take all decisions and actions which further the Corporate Objective, and which in his or her judgement are reasonable having regard to the CEO Limits.

# Accountability and monitoring

- The CEO is accountable to the Board for the authority that is delegated to the CEO, and the performance of the Group.
- The Board will monitor the decisions and actions of the CEO and the performance of the Group to gain assurance that progress is being made towards the Corporate Objective within the spirit of the CEO Limits.

# ACCOUNTABILITY AND MONITORING (ANNUAL BOARD CYCLE)

20

- Throughout the annual Board cycle, the CEO will report systematically in a spirit of openness and trust on the progress being made by the Group's businesses towards the Corporate Objective and towards shorter and medium-term plans.

# (Format and system of reporting)

- The CEO will determine the format and system of reporting, which will address material developments in the following areas, and will describe for each of them the potential impact on the achievement of the Corporate Objective:
  - The development and implementation of strategy, and the annual plan;
  - The business and financial performance of the Group, and material events in markets which are critical to the achievement of the Corporate Objective;
  - The activities covered by the CEO Limits.

# (KEEP THE BOARD INFORMED)

- The CEO will keep the Board informed in writing of decisions and actions that the CEO reasonably interprets to exceed the CEO Limits but are necessary and appropriate for the achievement of the Corporate Objective and the medium and short-term plans of the Group.

# (Monitor Performance)

- The Board will also monitor performance through the Board committees where it is more effective to do so, or necessary to avoid potential conflicts of interest.
- The Committees will focus on gaining assurance that the conduct and performance of the CEO and the Group comply with the CEO Limits.

# (BOARD AND ITS COMMITTEES)

- The Board and its committees will determine the information required.
- They may make direct requests for information including from the CEO, any employee of the Group, the external auditor or any third party.



# (THE CEO AND HIS OR HER NOMINEES)

25

- The CEO (and his or her nominees) will supply the Board and its Committees with the information in a form that is appropriate to enable the Board and committees to make assessments and judgements, to conduct inquiries, and to gain assurance that the decisions and actions of the CEO, and the performance of the Group, are directed toward the Corporate Objective and fall within the CEO Limits.

# (STRIVE COLLABORATIVELY)

- The Chairman of the Board, the chairmen of Committees, the CEO and the Company Secretary will strive collaboratively to ensure that effective systems are in place for the production and transmission of information and reports.

# (RELATIONSHIPS AND DIALOGUE)

- Relationships and dialogue between individual members of the Board and the CEO and senior executives that focuses on gaining a better understanding of the Group's business will be encouraged but will not alter the roles, accountabilities and divisions of authority in this Board Governance Document. (BHP Billiton 2006)

# End of Part 1

Part 2 will be discussed in the next lecture.