

Incorporating Governance Best Practice in the Organisation and the Board Room

A New Zealand Perspective

A presentation to the National Company Secretary Conference,
Kuala Lumpur, 28 June 2007

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New Zealand Background: Number of companies

- As at 31/12/05 409543 registered
- Approximately 160 public listed companies
- SMEs make up about 90 percent of all companies.
- Government-owned companies
- Local government-owned companies
- Jointly-owned government and local government companies.
- Trusts, incorporated societies and other governed organisations

Government Companies

- Government a significant shareholder.
- State Owned Enterprises
- Crown Research Institute companies.
- Crown owned companies.
- Airport companies (part shareholder)
- Health provider companies (now replaced by District Health Boards)

Crown Entities

- Government appointed boards for the governing of a range of central government activities: health providers, funding bodies, regulatory bodies – and more.
- Although not companies, many similarities to company governance.
- Most of the performance and governance tools used in SOEs expected of Crown entity boards.

Local Government

Used the company model for managing the delivery of community resources.

Now almost entirely replaced by Council Owned organisations, although governing boards retained.

Larger local authorities have formed holding companies to overview the governance of community-owned companies (e.g. port companies, shares in airport companies etc)

Advisory Boards

- Frequently formed by government agencies.
- Usual reason is to have proposals reviewed in business-like manner.
- Adds intellectual resource to agency without appointing staff or consultants.
- Expected to observe codes of governance and ethics in regard to board and member behaviour and performance.
- Sometimes regarded as “resource” boards.

Best Practice in the Boardroom

- Requires a chair with experience and leadership skills. And is inclusive.
- Balanced board.
- Board charter and code of ethics
- Defined reporting expectations
- Delegations to Committees and to management.
- Robust agenda
- Annual work programme
- Interests register and COI protocols

Role of the Company Secretary

- No legal requirement for Company Secretary in New Zealand.
- But most boards will have appointed one. Often lawyers.
- Vital to smooth running of the board.
- Manages director induction; maintains director manual.
- Delegations framework.
- Ensuring directors are aware of statutory responsibilities.
- Overview of report stream and report quality.
- Planning – with the chair – the board's work load and programme.
- Secretary to board and committee meetings, including agenda.
- Try to avoid being deemed directors.

Board Committees

- Growing use of committees.
- Expectation that there will be an Audit Committee
- NZX listing rules expect the formation of an Audit Committee.
- Risk management
- Remuneration
- Ethics
- Nomination.

Key Events

- Corporate Governance Guidelines issues by the Securities Commission.
- Corporate Governance Guidelines issued by New Zealand Stock Exchange in the context of revised listing rules.
- NZ IoD Accreditation

Forces For Change in Corporate Governance Effectiveness

- Growing disenchantment with boards by the public
- Growing disenchantment with boards by the politicians
- Growing pressure from the Green and CSR lobbies
- Growing awareness by directors that all is not well with the then CG systems
- NZ Stock Exchange listing rules.

Securities Commission

- Vitally interested in quality of corporate governance.
- Issues guidelines.
- Lists principles and standards that SEC expects boards of all issuers to observe and report on to investors and other stakeholders.
- More rules in pipeline.

SEC Principles

- Foster high ethical standards
- Boards should have balance of independence, skills knowledge, experience and perspectives.
- Use committees to enhance effectiveness.
- Integrity in financial reporting and disclosures.
- Remuneration to be transparent, fair and reasonable.
- Board should review processes periodically.
- Ensure the quality and independence of external audit.
- Foster constructive relationships with shareholders.
- Respect the interests of stakeholders.

NZ Stock Exchange Listing Rules

- Requires annual reports to include:
- “a statement of any corporate governance policies, practices and processes adopted or followed by the issuer.”
- Recognises that smaller, unlisted entities may not report but NZX strongly recommends that such a reporting practice be adopted by this large group.

Listed Companies

- NZX Listing rules place further obligations on boards.
- Includes number of independent directors.
- Membership of audit committee.
- Reinforced that chair and CEO positions should not be combined.

NZ Institute of Directors

- Encourages sound governance
- Publishes “Best Practice” guides.
- Operates development programmes.
- Manages the director accreditation programme.
- Undertakes governance research.

Accreditation

- **Accredited directors** are experienced directors. They will usually have a minimum of five years out of the last eight years as a director of an entity of substance'. They have demonstrated to IoD's Accreditation Board that they are committed to encouraging the highest standards of corporate governance, understand the Code of Practice and, where appropriate, are familiar with the NZX listing rules.
- Once accredited, all members must undertake professional development relevant to their directorships to ensure their knowledge and understanding of their roles and responsibilities as directors are kept up to date.

Board Size

- Generally accepted that boards will be around six to seven members.
- Government has a ceiling of nine, though usually fewer appointed.
- Chair role separate from CEO.
- May be a Deputy Chair – common in government companies.
- CEO may be managing directors, though not in government companies.
- Listed companies have defined minima for independent directors.
- Retirements are rotated, with government appointments normally of six years' duration.

Appointments

- Government has had a defined search and appointment process in place since 1988. Board skills profiling is key.
- Government tendency to appoint more first-time directors than private sector. But cronyism is a threat to governance.
- Government conducts prospective director programmes to increase the pool of potential appointees.
- Private sector companies moving away from “should-tapping” to engaging search firms. And more willing to look at younger/”emerging” directors.
- Emphasis on directors who add value and not merely accountants and lawyers.
- Independent director numbers guided by NZX listing rules.
- Private sector prepared to appoint off-shore directors but governments are reluctant.

Diversity in Board Appointments

- Government led the way.
- Endeavours to ensure more women are appointed.
- Identification of minority groups – ethnicities, disabled. Notably for government boards.
- Private sector now better focussed on appointing more women to boards, though still lags behind the Crown.

Government Governance Leadership

- Chairs are appointed separately from the board.
- Ambiguity over board confidence in chair leadership – when it goes wrong.
- CEOs not directors.
- No executive directors on parent boards.
- Subsidiary companies permitted.

Board/ Management Relationships

- Almost universally, the chair and CEO roles are held by different people.
- Increased focus on CEO performance.
- Board relates to CEO through chair, outside the meeting.

Governance and Management

- Important that senior management understand corporate governance.
- Enables better understanding of board expectations.
- Enables executive directors to perform with a governance hat.
- Strengthens senior management ability in appointments to subsidiary companies.
- Director development seminars also conducted for senior management.

Shareholder Board Relationships

- Expectation of better management of relationships.
- Takeovers and mergers have heightened interest by small shareholders, as well as institutional shareholders.
- Government boards even more mindful of importance of relationship. Statements of corporate intent public document of accountability and some protection of the directors as far as government directions are concerned.
- NZ Shareholders Association Inc

Corporate Social Responsibility

- “The board has a responsibility to to give management a mandate for a robust social service strategy” Robin Hood Foundation
- Board must be convinced the social strategy has relevance to the core business – and has pay-back.
- Some companies report on environmental performance.
- Even if the external concerns are misconceived, a company may decide it is good for business to accommodate those concerns.

The potential benefits

- Reputation
- Gaining and retaining customers
- Cost savings
- Innovation in products and operations
- Staff development
- Energy, enthusiasm and openness
- Supplier contracts

Environmental, Social, Economic Performance

- Economic/financial growth – environmental protection – social progress
- Opportunity to change the culture
- Reflect new values and new leadership
- Improve loyalty from external parties
- Increase supplier and customer commitment
- Contribution to environmental sustainability
- Reduce legislative demand
- Strengthen community/government relations
- Identify risk

Stakeholder Relationships

- Increasing importance.
- Important aspect of Corporate Social Responsibility.
- Some issues ignored at company's peril.
- In New Zealand, Maori interests important.
- Government companies have to be particularly mindful.
- Important for board to understand the company's stakeholder base.
- Can create conflict between directors.
- "Is it in the shareholders' best interest?"
- Board needs to know who the legitimate and significant stakeholders are.
- Where stakeholder interests intersect with the company's interests.
- Board needs to understand and approve steps towards stakeholders.

Induction Programmes

- Now a standard expectation that board will provide a new director with an induction programme.
- Less common but growing practice to provide a director's manual.
- In government domain, usual for new Crown directors to receive an induction programme on board/government shareholder relationships and expectations.

Director Development Programmes

- Accreditation requires directors to undertake development programmes annually.
- NZ Institute of Directors conduct range of development programmes.
- TBPL and other organisations conduct specialised director development programmes.
- Universities increasingly involved – TBPL works with the University of Otago in running an annual five-day programme.
- CCMAU conducts prospective director programmes.

Board Charter

- The Charter provides guidance to directors to assist them to carry out their duties and to meet their responsibilities effectively and in accordance with their professional standards.
- Guidance on best practice, not a compliance regime.
- Increasingly a source of reassurance to investors.
- Hard copy of typical charter circulated.

Code of Ethics

- SEC encourages boards to adopt a written code of ethics that sets out expectations for ethical decision-making.
- Encompass conflict of interest protocols, proper use and access to information, fair dealing, gifts, facilitation, bribes, compliance with laws and regulations.
- Reporting unethical decision-making or behaviour.
- How to deal with breaches.
- Board to monitor adherence.
- Publish code

Board Evaluation

- Early feature in government-owned companies.
- Initial resistance to concept.
- Important contribution to director reappointments.
- Applies to board as a whole, to the chair and to each director.
- Usually supported by documentation.
- Issue in keeping the process fresh.
- Increasingly adopted by larger private sector companies and other boards.
- May be conducted by boards or by external facilitators.

Role of Directors and Strategy

As Directors it is important that they understand the prime strategy the company is pursuing and that all the other strategies and organisational structure and design are consistent with this strategy

Board and Strategy

- The board must understand and approve a company's purpose and strategy. An effective board reins in managerial hubris and adventurism while encouraging the skilled assumption of business risk to generate wealth for shareholders and value for the company's stakeholders.
- The board “owns” the strategy and makes the strategic plan an integral component of decision-making.

Board and Strategy

- As a Board, devote your efforts to thinking about the vision and agreeing the strategy-creates better proposal evaluation and better focus for Board and Management
- Ensure that your Board papers for proposals start with a note/section on how this paper fits the strategy
- Ensure as a Board that you are measuring, and that Management/Company incentives focus on what will make the strategy work- the 80:20 Rule

Innovations

- TBPL is developing a list of products intended to enhance governance:
- Donor risk management.
- Equating board inputs with board outputs.
- Impact of board size on deliberations.
- Refined board evaluation.

Donor Risk Management

- Product developed by TBPL.
- Observation that agency investors under-investigate quality of governance in benefiting organisations.
- Obvious risk to investment.
- Risk prevalent in small organisations receiving public monies from agencies and international financial institutions.

Business Challenges

- Technology – including IT
- Intellectual property
- Listing rules
- Compliance costs – in company legal and financial issues; and in regard to Resource Management Act and Treaty of Waitangi issues.
- Greater stakeholder awareness
- Increased shareholder awareness.
- “Greening” of consumers.

Conclusion

- New Zealand boards are looking to strengthen corporate governance, as are those in other countries.
- Driven by attentions of investors and “monitoring” agencies.
- Attitudinal changes also driven by “greening” of stakeholders.
- Costs of compliance still a concern.