THE ROLE OF THE DIRECTOR AND THE BOARD

1.0 INTRODUCTION

In my experience there is no norm or template for corporate governance.

No two companies are the same.

This is not surprising because a board is a collective consensus making decision entity where the whole is far greater than the sum of the individuals.

This is both a weakness and strength.

A weakness when the board composition is wrong – a strength when you have a good mix of competent people on the board.

There are however, some basic tenets that are constant within corporate governance.

(i) you must have a board because the Companies Act requires it
(ii) the directors are responsible and accountable for the management of the company
(iii) they can delegate
(iv) good boards "reserve to themselves" functions where they can add value
(v) and the members must have common sense, business acumen and integrity.

Perfunctory boards, where the directors arrive, receive sanitized management briefings and then depart after a heavy lunch, are gone. Boards must add value no matter what the size of the company or whether it is a public listed company, co-operative, partnership, non-government organisation, state owned enterprises, a trust or SME.

1.1 Corporate Governance

Let's put things in perspective.

Business is about the sustained creation of wealth for the Stakeholders of which the Shareholder ranks first. This is the modern approach.

Boards are a committee appointed by Shareholders to look after their interests. Directors through management have to take account of other stakeholders such as:

- employees
- suppliers
- purchasers
- community
- professional associations
- bankers and investors
- government

This is called the “inclusive approach” and investors all around the world are demanding this approach as it leads to sustainable wealth creation.

I believe that Corporate Governance is a defined and promulgated interaction between the board and management in pursuit of sustained wealth creation for the stakeholders.

It is very important, indeed vital, that this interaction is correct and balanced. Gone are the days when management were the sole controllers of the entity and yet there are still some examples of this in New Zealand. There were some prime cases of them in the past also, but most of these have failed. It is also important that the board does not manage the entity – this will lead to confused accountability, stagnation and failure.

Good directors know how to get the balance right. On-going training is designed to ensure that directors know what they should and should not do.

1.2 Procedure

I am going to assume that not everyone here has a complete knowledge about boards of directors and how they should function, so I will go on to look in some detail at the board -its duties and composition. But first some points about the company itself - its components and inter-relationships.

2.0 WHAT IS A COMPANY?

First and foremost it is a corporation - a legal entity that is separate from its members or shareholders, separate from its directors and separate from its employees. It is, of course, true that shareholders have subscribed and paid for the shares which comprise the company's capital and thus have created it according to a formula prescribed by law.

These shareholders have certain rights as regards the company, but the company, once incorporated, is a separate legal entity, just as each shareholder and each director is a legal entity separate and distinct from the other. Every director must understand what a company is, and all the issues germane to its governance. Every director should have a good knowledge of the Companies Act 1993.

I would suggest to you that a company is an entity which has a formal legal linkage with those entities which interact with it. Further, it is an economic organisation operating through voluntary exchanges in the market place. A company has the constantly renewed short-term aim of the pursuit of adequate profit. It is implicitly assumed that companies, through the device of incorporation, which gives them potential immortality, have the overriding aims of survival and growth and to achieve them they must both make profits and adapt to changing conditions.

The need for corporate survival and growth imposes two basic obligations on company boards and management. First, to provide a fair return to the shareholders who have put up the risk capital required; and second, to retain a sufficient part of the company's earnings to permit a sustained level of reinvestment in new or replacement assets, research and development.

One reason why the company has proved such an effective investment vehicle in commercial and industrial activity is that it enjoys a continuity of existence denied to individual practitioners and traders.

Not only is the company's existence separate from the existence or involvement of any particular director or its shareholders, but it also escapes the impact of death duties and the normal dissipation of wealth through family groups.

3.0 THE SHAREHOLDER: RIGHTS AND INTERESTS

The nature and extent of shareholders rights and privileges will depend partly upon the provisions of the Companies Act and partly upon specific provisions in the Constitution. The latter are, in effect, the shareholders' "rule book".

Normally the rights of shareholders will include:

(i) the power to appoint and dismiss directors;

(ii) the right to receive annual accounts and to authorise the distribution of profits;

(iii) the power to wind up the company and distribute the net assets among themselves.

The shareholders have no power to direct or manage the company. The directors are in effective control of the company, and it is they who constitute the link between shareholders and management.

In turn, management represents the board in relation to employees, customers, creditors and the public at large. In short, the shareholders' rights are exercised through the board of directors, who must from time to time report to the shareholders and account to them for their stewardship.

The interests of shareholders are covered by statute, the companies Constitution, and, for a public listed company, in the stock exchange listing rules. The following are specifically reserved for discussion by shareholders:

(i) alterations to the Constitution;

(ii) business acquisitions or disposals over a certain limit;

(iii) issue of shares to directors and staff on special terms (for listed companies).

With regard to acquisitions and disposals there is no clear rule but I believe that where the assets involved comprise 50% or more of the total group's assets, the matter should be referred to the shareholders (a general rule to this effect is in the Companies Act - major transaction definition).

The 1993 Companies Act introduced a new ability in special circumstances for a minority shareholder to compulsorily require a company to purchase the shares of the minority shareholder for "fair value".

The same Act also allows the shareholders, in general meeting, to discuss management and strategic issues, however, the board are not bound by such discussions or any resolutions made.

4.0 INTER-RELATIONSHIPS

The relationship between the board, the shareholders and management is one of the most important aspects to be understood. Boards provide the strategic direction or vision and management implement this and then shareholders have the right to review it in general meeting. It would be most improper for management to deal with the shareholders.

Boards are about the future - Management is about today.

Further, the normal practice is that only the Chairperson deals only with the chief executive, and I will cover this later. He or she would only deal with other employees if the chief executive is away, or with the permission of the chief executive. Other board members would not normally deal with the chief executive or other employees, but it does happen. The correct procedure is to seek the chairperson's agreement and he or she will in turn discuss the matter with the chief executive. I am aware that some boards have specific rules that allow members to deal with direct reports to the CEO. The important issue is to have a clear understanding and agreement on dealing with management.

The board is responsible for communicating the shareholders requirements to management, the vision for the company, the determination of business objectives and supervising the achievement of these objectives.

Management, under the chief executive, is responsible for implementing and achieving the objectives. It should also be remembered that the board is responsible for appointing or removing the chief executive.

The accountability of the board to the shareholders can be clearly seen in relation to the annual report and accounts. While these are normally prepared by management, they must be signed off by the directors. They, the directors, must ensure by diligent enquiry that they are satisfied that these reflect the true state of affairs of the company. If they are not satisfied then they must communicate their concern to the chairperson and if this fails then they should seek a special meeting of the board.

Ultimately the annual report and accounts are adopted by the shareholders at a general meeting. That is the final authority.

There has been a growing tendency overseas, especially in the USA, for shareholders to be more involved in the company's affairs. I believe that this is in the best interests of the company and am pleased to say there is growing evidence of this in New Zealand.

I do, however, believe that companies need to look at the way and how often they communicate to their stakeholders. The old days of having one meeting per year (the AGM) with the shareholders in a location where not all the shareholders could get to, will not be adequate in today’s climate.

I note and commend, despite its inherent difficulties, a trend for companies to have meetings of shareholders in the major centres. In one case the AGM was held in Auckland and shortly after the company had a meeting in Wellington which was briefed by the Chairperson and the CEO.

All boards should regularly review how and when they communicate to shareholders that will be consistent with the "Insider Trading" regulations.

Likewise a good board identifies who its stakeholders are and has a pro-active communications plan on who is going to communicate to them, when, and a reporting back procedure.

5.0 OBLIGATIONS TO OTHER PARTIES

No business in this country can operate without some contact with government, local bodies, other traders and the community at large. In using "contact" I do not mean reporting in the formal sense that I have covered above.

It is the role of management to handle these contacts but the board has a responsibility to see that the company's image and reputation are maintained at the highest possible levels.

The board must therefore be aware of the company's legal obligations and must ensure that these are fully met. In the past there has been a tendency to appoint lawyers to boards to ensure that this aspect is covered; however, I am strongly of the opinion that boards should buy in this expertise rather than appoint it.

Hence I would recommend to you that if the board is grappling with a legal problem and is not satisfied with the "in house" advice, then it should retain an expert to provide advice. At the same time there may be a very good reason to appoint a lawyer (or accountant) to a board for their overall commercial contribution, and less importantly for their professional knowledge.

The board should insist on being kept fully informed of the company's financial position.

Matters of financial gearing, liquidity and, particularly, the giving of security for borrowed funds, including bank overdrafts, are the direct responsibility of directors. They may delegate authority but they cannot escape responsibility. I recommend that the directors regularly review the company's arrangements with financial institutions and ensure that fixed assets are economically utilized.

Employer-employee relations are becoming increasingly important in the conduct of company business, especially where large numbers are employed and many unions are involved. While direct negotiations are best left to specialist executives and employer organisations, directors should ensure that they are kept fully informed of actual and potential problems.

Matters involving superannuation or pension schemes, staff share or option issues, redundancy issues and the remuneration of the chief executive should be dealt with at board level.

The company's relationships with customers and creditors are clearly the function of management, but the board should ensure that the company's policies are such that these external relationships are conducted in conformity with a high standard of business ethics.

As far as creditors are concerned, directors must be aware of the provisions regarding reckless or wrongful trading. The Courts are clear in that directors cannot "fly blind" as to the state of the company's financial position.

Finally, in the modern world of business, most progressive companies develop a "social conscience" which leads them to take an interest in matters of concern to the community at large. In the formulation of policy, directors should establish the nature and extent of this very important aspect of company affairs.

Although philanthropic donations most readily come to mind under this heading, directors will also have to consider equal opportunity employment programmes and the support of cultural activities at a local level.

In meeting its obligations to other parties the company will, from time to time, have to make statements to the media or other interested parties. The board should have a policy regarding communications with these parties.

I suggest that:

- the Chairperson should be the spokesperson on matters relating to future developments, strategy, acquisitions, disposals, profit, etc. Thus matters that affect the shareholders or the wealth or the direction of the entity should be the domain of the Chairperson, who is the leader of the entity in the eyes of the shareholders and the public.

- the CEO should speak on matters germane to the management and operation of the entity.

6.0 EXECUTIVE AND INDEPENDENT DIRECTORS

The board of a company has defined legal responsibilities and its members reach collective decisions. To be effective its members must act as a group and all must contribute.

Hence it is normal for a board to be a small group of between five and ten members.

Executive directors are members of the board who also carry out executive functions within the company - e.g. the managing director, finance director, production director, etc. These directors are accountable to the chief executive for the conduct of their specific functions but as directors, are obliged to consider the overall position of the company. Such directors should, in my view, be appointed to the board because of the contribution they can make to the board, rather than as reward for service.

If there are going to be executive directors on the board then it follows that the chief executive *must* be one of them. His position in the company would be untenable if this was not the case. Around the board table there is no difference in responsibilities between executive and independent directors, however, there is evidence (eg RADA and AWA cases) that the courts are looking at different accountabilities based on information availability.

While it is unusual for a company's Constitution to release a managing director from the need to retire by rotation at annual general meetings of the company, no such exemption exists for other executive directors who may be voted out of office without this affecting their positions as employees of the company; however, this is most unlikely.

A non-executive director, or independent director, which is the terminology now preferred, is someone who is not engaged in the day-to-day operations of the company and thus expected to bring an outside view to the board table.

The sort of strengths that the independent director brings to the board are:

(i) a wider general experience of strategy formulation than is available within the company's senior salaried staff and an independence that is not influenced by considerations of career status;

(ii) an objective view of the performance of management in attempting to achieve the results set by the strategy of the company;

(iii) the professionalism to ensure that the board uses adequate systems to safeguard the interest of the company even where these may conflict with the personal interest of the executive directors.

Let me quote from a UK Government white paper on the conduct of company directors.

"Non executive directors can bring to the board a breadth of knowledge and experience which the company's own management may not possess. Even more important, they can increase the element of independence and objectivity in board decision-making. Not being involved in day to day management, they are able to take a detached look at the way in which the company is being run and its medium and long-term policies. They should provide independent supervision of the company's management.

In order to do this effectively, however, the non executive directors need free access to management information and there needs to be enough of them. One or two non executive directors on a board which is twenty strong are unlikely to exercise real influence."

Another quote, from *Practical Guidelines for New Zealand Directors.*

"In simple terms the board needs a number of part-time directors who do not have designs on anyone else's job, are not going to play internal politics and who do not see their career path as being influenced by their loyalty to the chief executive."

Another quote about the independence of directors from Peter Morgan, who was the Director General of the Institute of Directors in the United Kingdom.

"I could be a non-executive director and be very involved - I could own 30% of the shareholding for instance. I might be selling my services as a consultant, or be a major supplier. I could be non-executive but very dependent.

So, an independent director is one who has no extraordinary financial interest in the company and is independent of any interests that might want to influence the company."

I support this argument and suggest that independence must be absolute; however, I recognize that in practice this may not happen.

The growing trend, internationally, if for tighter definitions of independent directors and investors and bankers are calling for total independence.

The question of mix is one that can be debated for some time. The Institute of Directors is strongly in favour of independent directors forming the majority on any public company board. I personally recommend that all private company boards have at least one independent director.

6.1 Nominee and Alternate Director

The position of nominee director is not defined or provided for in the Companies Act, however, such appointments are common place in New Zealand, usually through pressure exerted by a shareholder or a group of shareholders. A nominee director can be defined as a director who achieves a seat on a company board at the request, or demand, of a shareholder or group of shareholders.

All directors must act bona fide in the interests of the company (as from 1 July 1994 special rules may be applicable in group company or joint venture situations) and this can lead to a conflict of interest for a nominee director. It is clear that there is nothing wrong with acting in a way which happens to be in the interests of your appointer, provided that you genuinely believe that this is in the best interests of the company as a whole. The interests of the company is paramount and a director who acted only in the interests of his or her appointer without regard to the interests of the company would be in breach of their fundamental duty.

For this reason the role of a nominee director can present special problems and it is not to be undertaken lightly.

Another problem relates to information. The basic principle is that information received by a director at board meetings is confidential to the board. It is the companies property and directors cannot use it for other purposes other than what is considered to be in the best interests of that company. There will be occasions when this is the case.

I suggest that it is good practice for a nominee director to discuss this aspect with the board. It may well be that the board will agree, because of the relationship between the company and the appointer, that the nominee director can pass all information to the appointer. Alternatively the board may say that the nominee director must apply to the board on each and every occasion when that director wants to pass board information to the appointer.

Alternate directors are directors appointed to attend board meetings on behalf of an appointed/elected director. Some Constitutions permit a director to appoint an alternate to act in his or her place in specified circumstances - usually if the director is temporarily unable to attend meetings because of absence from the country or ill health. In the case of a company with a director who is permanently resident overseas it is common for an alternate who is a local resident to be appointed.

I personally do not favour alternate directors and believe that such appointments can cause problems as well as creating legal problems. Appointments of alternates generally require the full agreement of the board and must be permitted in the Constitution.

6.2 Qualities of a Director

I have often been asked what are the qualities required to be a director or what does a director bring to the board table. I have asked a number of imminent directors this question and their consensus is:

- common sense;
- business acumen; and
- integrity

Many years ago directors came from two professions - law and accounting - but this is not the case today. As stated earlier if you need advice in these two areas, then buy it in.

It is difficult to define commonsense but I recall the advice given to me on this some years ago - "It is someone who has their feet on the ground and usually asks the obvious questions that others have been afraid to ask."

Business acumen may not relate to the particular entity when a director is first appointed but a director, after induction, must understand the business environment of the entity and be able to contribute on business matters.

Integrity is harder to define but I revert to Shakespeare “do unto others as you would have them do unto you.”

A recent forum of Company Chairs reviewed director qualities and agreed the following list:

- common sense, balance and judgement
- general business knowledge and continuing awareness
- ability to reason
- integrity
- specialist knowledge - where needed
- compatibility
- independent thought
- commitment - time, spirit, energy, courage and independence
- communication
- self evaluation
- understanding the role (management versus the board)
- boardroom experience
- personal achievement
- loyalty
- helicopter view - think conceptually, understand the big issues

We suggest that common sense, business acumen and integrity are general terms that cover the specifics above.

7.0 COMMITTEES OF THE BOARD

The board of directors is normally permitted by the Constitution to delegate its functions to committees composed of selected board members or managerial staff. However, the board as a whole still has to accept responsibility for the actions taken and decisions recommended by such groups.

Committees are commonly of two types:

(i) standing - those that perform a continuing function - usually administrative in nature; and

(ii) ad hoc committees that are formed to carry out a specific task delegated by the board with the requirement that they report back to the board before any decisions are made.

Care must be taken to ensure that the creation of a committee does not obscure the reality of collective responsibility or detract from the spirit of equal contribution that is so important to the successful operation of a board. There are a number of committees and I intend only to cover the major ones.

7.1 Establishing Committees of the Board

It is good board practice to record in the Board Minutes:

- the composition of committees of the Board;
- their Terms of Reference;
- tenure; and
- reporting back mechanism.

For standing committees this may only require confirmation of a previous minute but never-the-less it should be done annually.

7.2 Audit Committee

This committee exists to provide a direct point of contact, independent of management, between the board and the company's internal and/or external auditor. I strongly recommend this practice for all companies of a reasonable size. It is also used to review prospective auditors, negotiate the audit fee and discuss the role of the internal audit function with the outside auditors. The committee should be composed wholely of independent directors and its chairperson should be an independent director other than the chairperson of the board.

The primary purpose of such a committee is to assist the board in the proper discharge of its responsibility to produce accurate financial statements, and as such it will scrutinize the adequacy of both financial and operating systems and the capability of the people managing them. I firmly believe that all published financial statements should be prepared with reference to the guidelines laid down from time to time by the Society of Accountants.

The entire board should devote attention to this most important function. The Financial Reporting Act 1993 explicitly places the onus and obligations to prepare and, if necessary, file the relevant account on, **the directors**, not the company.

I recommend that any board seeks advice on the Teams of Reference for an Acedit Committee, and preferably not from an entity that gets revenue from auditing.

7.3 Remuneration Committee

This committee will be composed of independent directors - with the chief executive - as it owes its existence to the principle that executive directors should not be responsible for setting their own remuneration.

This committee would establish the corporate policy for the review of the remuneration but would not normally involve itself in setting remuneration levels for other than the managing director.

There is a growing practice to have a Board Committee which looks at such matters as:

- recruitment of new directors;
- induction of new directors; and
- training of board members.

This committee should also cover remuneration of the board and the senior management team.

My personal opinion is that committees should be limited in number and never given any powers that should rightfully and legally be those of the full board. I am opposed to "management committees" except in large not-for-profit organisations. A committee should be there to lighten the load of the main board by examining details. Committees, however, must report back to the main board and on important issues, make recommendations.

8.0 MAKING THE BOARD ADD VALUE

At the very beginning I said that corporate governance is "A defined and promulgated interaction between the Board and Management in pursuit of sustained wealth creation for the stakeholders."

I said there were some basic tenets that are constant one of which was delegation and another is "reserving to themselves."

I strongly believe that every board should annually review what business it is in and produce a Board Charter which comprises

- The board's mission
- The board's functions
- Its delegations and limitations to management; and
- The board's values

This is in effect the "defined interaction" and I believe this charter should be promulgated to all of the stakeholders. I have found that most employees have no idea what the board does except you can be sure all bad and hurtful decisions came from the board and all good decisions came from the CEO – a natural management play. However, if the employees see the Board Charter they will know and hopefully, appreciate, the role of the Board.

8.1 Board's Mission

The board's mission will usually differ from the Companies mission. The board are the fiduciaries for the shareholders and there are obligations, like making money, therein. The company's mission may be to make widgets but I suggest the board's mission is to make a profit. A bold board will actually try and state what that profit will be. So the board of XYZ may have a mission of "to make a profit of $ZM and a payout to shareholders of $A".

8.2 Functions

A board must then determine what it is going to do to ensure it fulfils its mission – its functions. Using its collective might it decides what it will do to create value for the company. This is called "retained activities". So a board says it retains the following for itself. It should then go on and say that it delegates all other matters to the Chief Executive with certain limitations. Only the board can undertake this exercise as it is the only entity that knows its strengths. It should do this at least annually and when circumstances demand.

Here is a list of functions that a board might consider:

- To determine annually its mission, functions and values
- To determine the Company's mission, vision and values
- To approve the Company's Strategic Plan and next year operating plan and budget
- To examine opportunities for investment or divestment
- To monitor management's performance against the agreed operating plan and budget
- To evaluate its own individual and collective performance
- To mentor, monitor, evaluate and reward the CEO
- Ensure compliance to all Acts, regulations etc
- Fully inform the stakeholders on matters relevant to the company
- Account to the shareholders on company performance
- Ensuring there are adequate resources to complete the set objectives

8.3 Delegations/Limitations

As stated above the board will formally record what it retains for itself to do, ie: its functions. It should also formally record its minutes "that it delegates all other matters germane to the management of the company to the CEO.

A good board will also place some limitations on the CEO like:

- No entering into financial instruments over $XM
- No capital equipment expenditure over $YM etc

8.4 Board Values

Board values will spell out matters pertaining to the board and its actions. Included could be:

- Trading in shares
- Communicating to others
- Declaring conflicts of interest
- Resigning when the board looses confidence in an individual.

To me the Board Charter is at the heart of good governance. If the board gets this right then it will add value to the company.

Once the charter is agreed the board should draw up a board Work Plan to ensure it actually does what it says it was going to do. This work plan should be produced at each board meeting and reviewed to ensure conformance. Finally the board, in its Annual Report, should make a statement about its Work Plan and the results.

9.0 COLLECTIVE RESPONSIBILITY

I think that this is one of the most important things that the independent director must grasp.

It is not unusual to find statements in the media by councillors who have a dissenting view from the decision taken by the council in a majority decision. This cannot happen in a company because all directors have equal and collective responsibility and accountability.

Decisions by the board are usually taken by consensus after full discussion. The chairperson has a specific role to ensure that all views are heard and that if there are variances in the opinions held that these are thoroughly talked through and hopefully at the end there is a consensus. This does not mean that boards take the easy option or indeed that they must always reach consensus.

There may be very rare occasions when the board is deadlocked and the chairperson will have to use his or her casting vote if the Constitution so allows. But, once the decision is taken then it is the decision of the board as a whole and directors who do not agree with the decision are bound by it and under no circumstances should they criticise it outside the boardroom. Likewise nor should they divulge, in part or in whole, papers that have been given to the board.

Good relationships between directors are important for the successful operation of the board. This does not mean, however, that directors must always be in agreement on every issue. Indeed if this was the case then I suggest that you would have a very unhealthy board. The adage is that directors can "fight like hell" trying to get agreement inside the boardroom, but never outside the boardroom.

If a director feels very strongly on an issue where the vote/decision has gone against him or her, then he or she can ask for the dissenting view to be recorded. This could be important at some time in the future when the director's actions are being examined. I would also make the point that you would not want to have a situation where you are continually recording dissenting views. Exercise this option carefully.

This also brings up the situation of the continual objection by a director or a group of directors. If a particular director or a group of directors are always taking a different view and there is constant conflict, then this can become unhealthy and can obstruct the board in the proper conduct of its business.

Obviously resolution must be attempted and here the chairperson plays a vital role. If all else fails, the majority of the board may come to the view that the board cannot continue to function effectively with the current membership. By far the best solution then is to persuade the difficult director(s) to resign. If this fails then it will be necessary to resort to the ultimate right of the shareholders to remove directors and the Companies Act provides a procedure for public companies which could be used.

10.0 INFORMATION AND BOARDS

Adequate information systems are a prerequisite of effective reporting to the board through which the company's performance, in relation to its strategic objectives, can be monitored. Regardless of how often board meetings are held, monthly reporting is essential if the individual director is to discharge his/her legal and moral responsibilities to the company.

Directors must insist that reports arrive, say, five days before a board meeting to ensure sufficient time for them to absorb and intelligently comment on the content of the reports. Insufficient time to do this is no excuse for the director to abdicate his or her responsibility.

I believe board's should regularly review the information they receive and the format that it is presented in. Too often board's accept what management provide. The papers concerned are the board's, therefore why should they not be concerned with format and content.

A wise board regularly reviews its information flow.

Regardless of whether the chief executive attends board meetings, experience suggests that it is wise to invite functional managers to attend for a brief period during meetings to report directly on specific aspects of their area of responsibility. This can be done with one functional or departmental manager appearing per board meeting on a rotational basis. In this way directors are able to meet senior managers and have the opportunity to assess their competence.

What then are the characteristics of a board? The following is a suggested list:

* sense of constitutionality and separation of power (internal vs external);
* collective responsibility;
* focus on adding value;
* balance of experience and skills;
* team dynamics;
* maintain momentum (healthy impatience, timeliness in decisions, sense of urgency);
* relevant balance (external/future and internal/monitoring) and (conformance versus performance
* capacity for interactive self development and self evaluation; and
* leadership.

11.0 MODUS OPERANDI

Every director should play as active a part as they are capable of doing in respect of all matters that come to the board for a decision. They should make it their business to understand every report and every issue before the board. I know that there are some who will, on individual matters, be able to contribute more than others because of their particular background. For example, an accountant may find financial matters easier to grapple with than a director who does not have an accounting background. Notwithstanding this, it is beholden on all members of the board to study their papers and ensure that they understand them as well as they can.

Directors should never hesitate to ask questions, and, as I have said before, provided they have cleared their approach, there is no reason why they should not seek clarification from management. Clearly, a director must insist that he or she is given adequate information to be able to monitor the company's performance, discern trends, question inefficiencies and make sound decisions.

Management accounts must be sufficiently detailed, having regard for the size of the enterprise, to enable directors to identify matters which require probing. By asking questions they will identify matters calling for changes of policy or for specific decisions.
Directors must have a general understanding of the techniques used in the business so that they can appreciate the critical nature of certain factors. However, an intimate knowledge of the particular business is less important than a full understanding of general business principles and directorial duties and responsibilities.

A good practice is to "rapid read" board papers immediately they are received in order to establish any matters that you require more information on or wish to ask questions about, prior to the board meeting. The papers can then be read in detail just prior to the meeting.

Remember:
- a good director takes two hours preparing for every hour at the board table:
- a bad director opens their papers as they enter the board room.

12.0 CONFLICTS OF INTEREST

Directors must not abuse their position of trust. The director owes to the company and its shareholders a fiduciary duty which makes it incumbent upon the director not to undertake any role or take any stand which could be considered inconsistent with the proper discharge of a director's duties.

They cannot serve two masters and be loyal to both. Any conflict, or possibility of conflict, between the director's personal interests and their duty as a director should be avoided. It should be remembered that a director's primary duty is to the company.

It is inevitable that a person who holds multiple directorships is going to widen significantly his or her knowledge of business tactics, policies and procedures. If that person is in business on their own account that person may learn something which could be of personal benefit. However, it is natural that a broadening of a director's knowledge and experience will make them a more valuable member of any board. There is nothing wrong with using information in a general way, so long as no particular company is advantaged or disadvantaged. When competing business interests arise, or are likely to arise, from any item on a board agenda, the director concerned should, at the very least, declare an interest and refrain from voting. In some circumstances, if the issue being debated is a particularly sensitive one, the director would be wise to seek the chairperson's permission to retire temporarily from the meeting.

A conflict of interest frequently arises where a director of a company sits on the board as a nominee or appointee of a second company which has a financial interest in the first company. The director has a fiduciary relationship with the company on whose board he or she sits and this duty requires the director not to take into account personal interests, or the interests of family, friends and other business connections. Unless this fiduciary relationship is maintained with the highest standard of integrity then clearly one shareholder is being placed at a distinct advantage over other shareholders who are not represented on the board. This situation is quite unacceptable.

In a country as small as New Zealand it frequently happens in the normal course of business that a company enters into a contract with another company and the two contracting companies have a common director, or a director of one company has an interest of some kind in the other company. The Companies Act is clear to the legal requirement:

It shall be the duty of the director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company.

The Constitution of most public companies spell out the procedures to be followed in situations where a director has an interest in a contract which the company proposes to enter into. However, apart from the legal and other provisions, it is good boardroom practice for a director in these circumstances to stand aside from any discussions on the contract, to formally declare his or her interest and to refrain from voting. The minutes of the meeting should record this.

I also believe a director should inform the Chairperson when he or she knows that one of his/her fellow directors has a conflict. The adage is “declare, declare, declare”.

13.0 THE BOARD IN OPERATION

13.1 The Chairperson

Most constitutions provide that the directors elect their own chairperson and may determine the period for which the Chairperson may hold office. While it is desirable for the purposes of continuity, that the role of Chairperson is not subject to frequent change, most boards would have the election of Chairperson as the first item on the agenda for the directors' meeting following the annual general meeting. In most cases the result will be the confirmation in office of the incumbent but nevertheless the Chairperson's election is an important item as he or she must have the faith of his or her fellow directors and the appointment should be reviewed on a regular basis.

Obviously the Chairperson holds office for one year; however, in practice they hold the office for longer periods. Unless the Constitution says otherwise there is no maximum period for the Chairperson to hold office. The Chairperson is the leader of the board and the board’s performance is pivotal on how good the Chairperson is.

The role of the Chairperson is to:

* maintain close, but independent, working relationship with the CEO;

* harness the collective skills of the board and executive team to achieve business objectives and maintain confidence of stakeholders;

* ensure timeliness and relevance of information;

* encourage directors to have full participation in board deliberations;

* lead the board evaluation process;

* demonstrate qualities of leadership and good interpersonal skills;

* efficiently conduct board meetings.

* ultimate decision maker

13.2 Conduct of meetings

The chairperson takes the chair at directors' meetings and at the meetings of the shareholders. To enable him/her to carry out the role effectively the chairperson must have a good knowledge of meeting procedures and be able to handle, when necessary, the technical aspects of resolutions, amendments, points of order, etc. He/she must have sufficient knowledge of company law and the contents of the constitution to be able to deal with issues such as poll voting and determining what business may be properly discussed at a general meeting.

Chairpersons will make their own decisions as to the degree of formality they bring to the role. In most cases it is necessary to run general meetings of shareholders along fairly formal and structured lines to retain proper control. Board meetings tend to be less formal and the chairperson has a duty to ensure that all are heard. However, the chairperson needs to retain a sufficient degree of control so that the authority of the chair is always recognised and so that a degree of formality can be reintroduced when it is required to make progress.

One of the purposes of a meeting is to make decisions and the chairperson must take care that the decisions are properly understood and recorded. It can be difficult for the secretary to distil a decision from a wide-ranging discussion and usually it will be best for the chairperson to ensure that discussions and debate are completed with a reasonably formal resolution recording the conclusions reached. In the case of shareholders' meetings all decisions should be recorded by way of a formal resolution.

It is not my intention to cover the conduct of annual general meetings in any detail but I do make the following points:

(i) the minutes of the previous AGM are tabled for inspection (they are approved by the directors at the board meeting after the Annual General Meeting);

(ii) it is usual for the chairperson to move that the Accounts and Directors' Report be taken as read;

(iii) the Auditors' Report must be read out aloud to the meeting preferably by the auditor who should be allowed to speak to the report if there are matters of concern;

(iv) these documents must be received and adopted;

(v) the directors must be elected individually or, if agreed by resolution, as a group;

(vi) the auditors must be appointed, except in the case of private companies, and it is normal to authorise the directors to set their remuneration;

(vii) it would also be normal to fix the aggregate sum allowed for the payment of directors' fees.

Ordinary resolutions and special business only requires a majority vote by the shareholders; however, special and extraordinary resolutions require 21 days notice and a 75% majority.

13.3 Preparing for the meeting

There is nothing more insulting to the management of a company than the director who has not read papers and tries to ask questions on matters that are clearly laid out in the papers provided to the board. Directors must make a detailed study of all their board papers and while time taken will vary from director to director and company to company, it is normal to spend two hours preparation for every hour spent at the board table; for complicated matters more time may be needed.

When joining a board that has been in operation for some time the new director should plan very carefully for the first meeting. The chairperson should arrange an induction which will probably include a visit to and briefing on the major operations. The new director should be given the minutes of recent meetings and should be at liberty to visit the company's premises to examine the minute book and accompanying papers, e.g. financial reports, cash flow statements, production reports and strategic briefing papers, etc.

If the whole board is new then the chairperson and the chief executive should arrange an induction programme for the whole board. The chairperson will also have to be fully conversant with the procedural matters that have to be covered at the first meeting, e.g. Constitution, etc.

As previously stated, board papers must be in the hands of the directors, at least, five days before the meeting. This will give the board member adequate time to examine the papers in detail. This does not mean that late papers should be excluded or that papers cannot be tabled but this is undesirable. In the latter case it makes sense that the chairperson allows time for the board to read these papers. The norm, however, should be that papers are received in sufficient time for them to be considered. The other norm is that late papers should not be addressed and decisions taken if the board is not happy or comfortable with the contents. In such cases it may be more appropriate for the papers to either be deferred or cleared out of session. There are few things more annoying to a busy director than to regularly receive late papers or to have papers of consequence tabled at the meeting. If a director is concerned about, or cannot understand, a paper that is to be discussed by the board then he or she should discuss it with the chairperson. If appropriate, the chairperson can then arrange for the director to talk to management about the paper. The director is obliged to take all steps necessary to ensure that he or she understands and can contribute to the matters being addressed at the board meeting. One area that seems to concern a number of directors is that of financial papers. If these continually cause difficulties then a short course or some time with the financial controller may be appropriate.

Another area which has come to the fore over recent years, and the Cory Wright and Salmon collapse typifies this, is the quality and accuracy of the information supplied to the directors. Remember at the end of the day the directors are liable and if they are not getting correct or adequate information then they must take all reasonable steps to ensure they get what is required. If there are some doubts in a director's mind on a matter then once again he or she must tell the chairperson.

So, what sort of information should a board member expect. A suggested list is:

(i) financial statement for month and year to date showing Actual against Budget and last year;

(ii) cash flow projections to at least the end of the financial year and preferably for 12 months;

(iii) operating statement by the managing director or general manager;

(iv) major policy matters requiring decisions;

(v) capital expenditure proposals that exceed the CEO's authority;

(vi) future developments and expansions;

(vii) review of strategic planning documents.

Remember that historical data is primarily to provide the background for considering the future which is the board's prime concern.

This raises another important point and that is the chief executive's delegation. It is most important that the board decide on and record the budgeted level of expenditure it authorises the chief executive to apply to any project.

13.4 Evaluating the CEO

Most boards, and indeed this really is essential, should review and evaluate the Chief Executive Officer. The Chairperson then is required to inform the CEO of the Boards findings. Some boards also do this, together with the CEO, for the direct reports to the CEO.

The following guidelines on CEO Evaluation and Appraisal was agreed at a Company Chairperson's Conference.

DEFINITIONS

Evaluating is the on-going process of reviewing performance.

Appraising is the formal process of communicating the evaluation to the person under review.

COMMENT

Evaluating and appraising CEOs is a process designed to ensure full and frank two way communication between the board and its chief executive and should be founded on the letter of appointment.

This formal process does not replace the informal evaluating and counselling that normally occurs, but rather should be viewed as positive addition to the relationship between the board and the chief executive.

GUIDELINES

Evaluation is based on performance against agreed expectations which will have regard both for the needs of the entity and the personal qualities of the CEO.

Evaluation is the responsibility of the Chair and should be done in consultation with the whole board.

Appraisal should be done by the Chair, on a regular basis as determined by the board, and recorded.

The CEO should also provide "feedback" on their perception of the board and its operations. The CEO should also speak about their personal development and expectations.

At the conclusion of the appraisal it should be quite clear to the CEO what the board think about them.

13.5 Evaluating the Board

If it is good enough to evaluate management then surely it is good business practice to evaluate the board members individually and the board collectively against agreed objectives. Some boards do this and it is a growing practice.

I have already covered the board setting a work plan and objectives.

I believe it is good practice for the Chairperson to review each member of the board's performance in achieving the work plan and objectives. The Chairperson may seek advice and comments from other members of the Board but in the end he must do the analysis and then appraise each of the board members individually. There are some excellent guidelines on Director and Board Evaluation available.

The Chairperson should not be exempt from this process and I recommend that the Deputy Chairperson does the appraisal of the Chairperson, but the former does the reporting. If the board does not have a Deputy Chairperson then they should appoint a member of the board to undertake this. Remember, however, that the Chairperson is evaluated annually when they seek re-election.

Boards must also have a budget and training programme for its members development.

13.6 Director Remuneration

Without a doubt the most pressing problem in company direction is the low level of director's fees.

On average directors fees in New Zealand are half of those paid in Australia. Directors only have themselves to blame for this.

There has been a recent, growing trend of good experienced people turning down appointments because the fees were too low and they can get a better return on their time elsewhere. If we are going to attract the right sort of people then we are going to have to ensure adequate remuneration.

I suggest that all directors must have as one of their priorities the need to get directors fees to a reasonable level.

In terms of setting fees I suggest the following based on the premise that at minimum directors are professional advisers and have liability. A formula could be:

- determine the number of board meetings per year = X
- establish the average duration of the meetings = Y

- remember it take two hours preparation for every hour at the board table = 3
- establish a professional hourly rate which recognises the complexity of the entity, the location (fees are less in the South than in the North) and the size of the entity. This hourly rate can be fixed relative other professional hourly charges e.g. those of accountancy or legal = Z

The Annual Fee is: X x Y x 3 x $Z = $

13.7 Succession and Development

One of the board's functions is to ensure there are adequate resources. One of these resources is people.

It is important that boards have succession plans for Management and the Board

The former is usually well covered but the latter is not usually covered at all. I am aware of a large company which recently 'woke up' to the fact that the Chairperson and Deputy Chairperson were both retiring, on age, within the next 10 months.

Good boards will plan for their own succession. They need to know well in advance who will be retiring or who may be asked to retire due to poor evaluations. It is good practice to start to look for replacements at least 12 months before they are needed.

As stated elsewhere, directors bring commonsense, integrity and business acumen to the board table. Notwithstanding some directors may not have previous board experience and some may have weaknesses in some specific areas; e.g. accounting, marketing, etc. All directors need to keep abreast of changes in the law or regulations that impact on company direction.

It is essential, I believe, that the Board has a training plan for itself and that finance is allocated for this annually. Every director should attend a course of some nature, relevant to company direction, each year to keep themselves current or improve on areas where they do not have expertise.

13.8 Code of Practice

Anyone can call themselves a director. Unlike accountants, lawyers, doctors, etc. directors do not have to belong to a professional association, nor do they have to have an annual practising certificate - quantity surveyors and clerks of works do.

I believe every country should have a code of practice for directors as is the case in many countries but not New Zealand. I also think directors should be licenced as in Malaysia. There is considerable work to be done in this regard in New Zealand.

14.0 CONCLUSION

I would like to sum up by saying that the essence of directorship is integrity, vigilance and common sense. Norman Johnson, a well known Auckland director, put it this way at a seminar -

By integrity I mean uprightness, honesty, sincerity as the dictionary says. It means more than that.

The director with integrity:

- knows a conflict when he sees one
- will not profit from dealing in his shares through inside information
- will not yield to pressure
- will not be influenced by non-relevant self serving factors
- can recognise unethical behaviour or a shady deal
- will not deceive shareholders.

By vigilance I mean an honest and constant review of your company's "good health". We can all skim over matters but the vigilant know when to focus and on what.

The most important ingredient is plain old "common sense”.

In this paper I covered a number of matters, all based on my personal experience, which I think should be considered by boards and directors.

To me the key things are:

- Have competent performing directors
- Make sure the board knows what business it is in and has a charter
- Have a Board Work Plan
- Business performance
- Communicate to the stakeholders
- Practice the craft
- Perform with integrity

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