TOMORROW'S BOARDS

CREATING BALANCED AND EFFECTIVE BOARDS

Anthea McIntyre

AUSTRALIAN INSTITUTE of COMPANY DIRECTORS

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Australian Institute of Company Directors
The Australian Institute of Company Directors is a member institute for directors dedicated to having a positive influence on the economy and society by promoting professional directorship and good corporate governance. We deliver education, information and advocacy to enrich the capabilities of directors, influence the corporate governance environment in Australia and promote understanding of and respect for the role of directors. With offices in each state and more than 29,500 members, we represent a diverse range of organisations, from the top 200 publicly listed companies to not-for-profits, public sector entities and private companies.

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July 2011

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Foreword

BRINGING TOGETHER A DIVERSE range of skills and experience is an important aspect of good corporate governance and a pre-requisite for a constructive and challenging board culture. Although women comprise around half of the workforce, are well represented in professional and management ranks in their early careers, and are increasingly found in leadership positions throughout our community, their appearance around Australian board tables is extremely modest.

The explanation for the current situation is complex and deeply embedded in the cultural and behavioural norms in and around the boardroom. For many years, the debate centred on 'how to explain' rather than 'how to change' the status quo. But today, compelling evidence of the value and contribution of women in the boardroom, and the positive impact they have on corporate culture and performance, makes change unarguable. Our current economy, where skills and experience are scarce at all levels, makes folly of a system where a significant source of talent is underrepresented at the board table.

The Australian Institute of Company Directors has recognised that board diversity is an important issue for the director community. In 2009, the Australian Institute of Company Directors was prominent in assisting with the development of the diversity reporting regime, which has now been incorporated into the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations. However, more needed to be done.

The Australian Institute of Company Directors took a very public position promoting change at the top. It devoted significant resources to researching the subject and examining how best to make a difference. These efforts led to a number of practical, wide-ranging initiatives being developed and implemented by the organisation. Prominent directors championed the cause, forums were organised to publicise the issues and debate the possible solutions, an extensive database of "board ready" women was established and initiatives were taken in the areas of mentoring, recruitment and training. As a result, the Australian Institute of Company Directors has become a centre of excellence on diversity, pioneering a range of practical measures to promote change in Australia that is particularly suited to our business environment.

Anthea McIntyre has been at the centre of this activity, speaking to anyone and everyone interested in the issue, organising and attending countless discussion groups, liaising with like-minded organisations, briefing directors and the media on the subject and collecting, analysing and monitoring key statistical data. She is a key source of ideas, energy and initiatives on diversity and early signs indicate that these efforts are bringing about change.

This book includes suggestions and ideas for creating a vibrant and diverse board. As a practical guide, it draws on the wisdom of senior practising directors and other experts, and reflects the experience and perspectives gleaned by Anthea and others over the last couple of years as they helped the Australian Institute of Company Directors to establish its leadership position on the issue.

Current trends in board appointments suggest that progress is being made. In 2010, more than 25 per cent of all ASX200 board appointments were female, rising from a paltry single digit figure in prior years. And 2011 is showing further improvement. We are on the way but have a long way to go. I am confident that the culture of the boardroom is genuinely changing and that diversity is now "hard wired" into board processes, customs and behaviours.

We will not succeed with our diversity goals until the tougher challenge of female representation in senior management and professional ranks has been tackled in a sustainable way. This hits at the heart not just of corporate culture but also of society and community norms. It will be harder and slower to change. But with diverse boards taking the lead in implementing more flexible employment policies and practices and encouraging innovation in the workplace, we can make a huge difference. And with the need to ensure all of our skills and resources are employed productively, why wouldn't we? It is just common sense.

Rick Lee FAICD
Chairman
Australian Institute of Company Directors

July 2011

Introduction

AN EFFECTIVE BOARD OF DIRECTORS is crucial to the success of any company. Board members play an integral role in public, private and not-for-profit companies of all sizes on a vast range of issues including corporate strategy, risk, company performance, managing finances, increasing company value, maintaining good corporate governance and the appointment, evaluation and succession planning of the chief executive officer and the board. Given the importance of these issues, recruiting and appointing knowledgeable and skilful directors is critical, and ensuring that there is an appropriate mix of skills, experiences and backgrounds represented on the board at all times is imperative.

The membership of boards and the selection practices adopted by boards and nomination committees is increasingly being subjected to greater scrutiny by shareholders, proxy advisors, the media, shareholder associations, lobby groups, customers, employees and other stakeholders. This is even more pronounced for publicly listed entities. The commencement of the ASX Corporate Governance Council's new principles and recommendations on diversity from 1 January 2011 means that the search and selection processes for new directors adopted by listed entities and the approaches taken in addressing inequities in female representation at all levels in an organisation (or the absence of such approaches) will be on the public record for all to examine and critique.

This publication aims to provide practical guidance to boards, nomination committees and professional search firms on the composition of boards and the process for selecting the most appropriate directors. It highlights the advantages of a diverse board and includes suggestions for developing selection criteria and managing the executive search process so that new directors are selected from a broadly-based candidate pool, comprised of individuals with an appropriate mix of skills, knowledge, experience and sound judgment.

Board appointments must always be made on merit, with the best suited person being selected. Nevertheless, it is concerning that in Australia women comprise:

- 50.2 per cent of the population[1]
- nearly 50 per cent of the workforce[2]
- 56 per cent of all higher education students[3]
- 55 per cent of all university graduates[4]

and yet only comprise 4 per cent of line managers, 8 per cent of senior executives and 12.5 per cent of directors of Australia's top 200 companies. This has raised questions as to whether companies and boards are in practice recruiting for these roles based solely on skills, experience and performance, without a gender bias.

While there has been substantial improvement in the past 18 months in the number of women appointed to ASX 200 boards, there has been little if any improvement in recent years in the representation of women at the executive and line management levels, which is a common source of new directors.

Achieving greater gender diversity is the key focus of this publication but diversity in other areas should also be actively encouraged. Many of the suggestions and tools provided in this book for increasing the representation of women on boards and in senior management positions can be easily adapted to assist with improving other forms of diversity.

Chapter One

Board composition and selection

This chapter provides an overview of how a board should be structured and managed. It examines areas such as the size of a board, member selection, responsibilities of key positions, the amount of time that will be required to perform board duties, and the competencies that should be represented on a board.

Boards should:

- adopt a planned and considered approach to board composition and selection;
- ensure that the board contains an appropriate balance of executive, non-executive and independent directors;
- consider whether it is appropriate for the board to delegate some key matters to specialist board committees;
- consider whether the board size is appropriate;
- review regularly the composition of the board and consider whether each director has sufficient time to commit to the role having regard to the needs of the board and its committees and the company generally, and also whether the directors have the appropriate skills, experience and expertise needed; >

- ensure that the board has succession plans in place for each director to maintain an appropriate mix of skills, experience, expertise and diversity on the board at all times;
- reconsider the board's current selection practices and consider whether they are in line with best practice, reflect the current needs of the board, and appropriately take into account diversity issues;
- provide transparency around the selection of board candidates by publishing the methodology adopted for selecting and appointing directors on the company's website; and
- consider whether a nomination committee is appropriate and, where applicable, comply with ASX Corporate Governance Council's Principles with respect to nomination committees.

BOARD COMPOSITION AND selection processes are evolving in response to global markets and increased competition as the needs of companies change. There is also increasing scrutiny from institutional investors, proxy advisors, shareholders, the media and other stakeholder groups in the composition and selection of boards as well as in the company's approach to succession planning.

In the case of public companies, while the shareholders should ultimately determine who sits on the board, this choice is strongly influenced by the board and its nomination processes. As the Productivity Commission highlighted in its 2009 inquiry into executive remuneration in Australia, while shareholders are entitled to nominate and elect their directors, it is the board that has the mandate and resources to select nominees from a pool of candidates, as well as intimate knowledge about the skill-sets needed by the company.[5]

In this context, it is imperative that boards adopt a planned and considered approach to board composition and selection to ensure the requisite skills and qualities needed for effective board leadership are actively sought and obtained.

Board composition

The ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (ASX CGC's Principles), which apply to all entities listed on the Australian Securities Exchange (ASX) on a 'comply or explain why not' basis,[6] state that a company should 'have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties'.[7] This basic principle is equally applicable to all companies, not just listed entities.

There is no set formula for determining the "effective" composition of a board. Each board is different and much will depend on a range of factors including the organisation's size, the stage of the organisation's development, and the type of organisation (including whether it is a not-for-profit organisation, listed public company, an unlisted public company or proprietary company).

Experienced company chair, Don Argus AC FAICD, discussed the importance of board composition at the Australian Council of Superannuation Investors' annual conference in 2010, and opened his speech as follows:

> The most crucial determinant of a well-governed company that consistently performs highly is the right board with the right blend of skills and experience. In practice, this means that the board must agree, on behalf of shareholders, on the requisite skills and experience individual directors must possess, as well as the blend of skills and experience across the board as a whole and its committees. The board must be able to debate to a conclusion, challenge management robustly and consistently make the right decisions to create value... It can no longer be accepted that just anyone can discharge duties of a non-executive director and much care needs to be undertaken to ensure a board is populated with the right skills to be able to 'smell the smoke' and engage with outcome thinking. If the board is structured appropriately, the company will perform well over time.

Board membership

The composition of a board will depend on the nature of the company and the needs of the business. In general, however, boards in Australia include:

- a chair – usually an independent non-executive director elected by the directors, but occasionally an executive director (who is employed by the company and is a member of the executive management team);
- one or more executive directors (EDs) – it is becoming increasingly more common in Australia for the chief executive officer (CEO) of the company to sit on the board as an executive director (commonly titled the managing director). Sometimes the chief financial officer (CFO) will also be an ED (although not always); and

- one or more non-executive directors (NEDs) who may or may not be independent directors of the company. However, many boards in Australia (particularly private company boards) do not have any NEDs.

There are some limitations on who can be appointed as a director. For example, an individual must be at least 18 years of age before he or she can be appointed a director of a company.[8] Further, a person who is disqualified from managing companies can only be appointed as a director if the appointment is made with the permission of the Australian Securities and Investment Commission (ASIC) or with the leave of the court.[9]

Chair

The chair is responsible for leading the board and also for the efficient organisation and conduct of the board. The chair is expected to facilitate the effective contribution of all directors and promote constructive and respectful relations between directors and between the board and management.[10]

The review conducted in 2009 by Sir David Walker into corporate governance in banks and other financial industry entities in the United Kingdom (UK) known as the 'Walker Review' discusses research which found that an effective chair must be able to achieve each of the following:[11]

- **integrate the board's collective thinking** – this is possible when a chair excels at seeking and sharing information; building ideas into concepts; analysing and considering multiple perspectives and alternatives; and can subvert his or her individual needs for commitment to a common goal.
- **empathise with and promote openness in board members** – the ability to listen at multiple levels is critical to being a successful chair and ensuring good team dynamics. Listening to what is not being said is as critical to engendering trust and respect as listening to the words that are spoken.
- **facilitate constructive interaction between board members**
- **develop other directors** – chairs are increasingly expected to provide active coaching, mentoring and development of talent within the board, in particular with new board members.
- **communicate complex messages succinctly** – effective communication,

through written and spoken means, reduces the cognitive load on the board, allowing more time for analysis, exploration and learning.
- **foster collaboration** – the ability to identify boundaries and successfully navigate across and within them is critical to creating a culture of collaboration and efficiency.
- **nurture continuous improvement** – good behavioural objectives include continuous evaluation of board performance against internal and external benchmarks.

The need for these behaviours and traits will vary depending upon the maturity of the company and its board members.

Experienced company chair, Kevin McCann AM FAICD, recently made the following comments regarding the role of a chair:[12]

> For the chairman in particular, a key task is to implement effective connections between directors and the executive team, through board meetings with operational management...
>
> There is no doubt that, in practice, directors look to their chairman to play a pivotal role in facilitating fully informed and effective decision-making. The chairman must be wary of the tyranny of the agenda and strive to break out of that straightjacket, which may restrict the time available for free-flowing discussion…
>
> The chairman must initiate arrangements for putting directors in touch with key management personnel. … I regard [board workshops] as particularly effective. They involve presentations by management – not just the senior executive group but the younger executives who are the company's future. Directors acquire a deeper understanding of the company as a dynamic human institution. But there should also be time for non-executive directors to meet without management, to exchange views in confidence about management's performance and strategies.

In the case of ASX-listed entities, the ASX CGC's Principles recommend that the chair be an independent director or, where the chair is not independent, for the board to consider appointing a lead independent director.[13] In the case of entities regulated by the Australia Prudential and Regulation Authority (APRA), the chair *must* be independent and must not have been the CEO of the entity at any time in the previous three years.[14]

While it is generally good corporate governance for the role of the chair and CEO to remain separate, the Productivity Commission in Australia has noted that there may be limited circumstances where it would enhance company performance for the roles to be held by the one person (for example, a small entrepreneurial company where the equity market may view a dual CEO/chair as positive).[15]

In the case of ASX-listed entities, the ASX CGC's Principles recommend that there be a clear division of responsibility between the role of the chair and the role of the CEO and that this division should be agreed upon by the board and set out in a statement of position or authority.[16] Australia has a much higher proportion of companies that separate the role of chair and CEO than the United States (US). In 2008, around 80 per cent of all ASX-listed companies had a separate chair and CEO; with the proportion even higher for larger listed companies (92 per cent of the top ASX 150 had a separate chair and CEO).[17] In contrast, in the US, in the same year only 25 per cent of the top 200 companies had a separate chair and CEO.[18] A survey in 2010 of US' top 100 companies found that only 30 per cent of such companies separate the roles.[19]

Executive directors

EDs are able to bring company-specific knowledge to board deliberations and their presence can enhance board effectiveness and company performance.[20] According to the Productivity Commission, there are, on average, two EDs on ASX 300 company boards, typically the CEO (generally titled the managing director) and the CFO.[21]

UK boards typically have a larger proportion of EDs on the board than is the case in Australia, the US and Canada. In the UK there is a concern that a board with only two EDs puts the CEO in an unduly strong position that allows them to control the information flow to and from the board. According to the Walker Review, this increases the board's vulnerability to overdependence on one individual for decisions on major strategy and risk issues.[22] This vulnerability is said to be amplified further in situations where the personal style or tenure of the CEO inhibits constructive challenge from within the executive team.[23]

Nevertheless, there is no evidence to suggest that a higher proportion of EDs is more effective. As with board size, the ideal board composition will depend on the particular needs and circumstances of each company and is therefore best left to the judgment of the members of each board.

There is, however, evidence that the stronger the executive presence in any board, whether in the form of one dominant CEO or through participation by major business units, the greater the risk that overall board decisions will be unduly influenced by what is often described as 'executive group-think'.[24] It is important therefore for a chair to foster open debate and challenge between management and the board and also within the board which should not be dominated by a single voice.[25]

The independence of directors

Independent judgment and decision-making is a basic requirement for an effective board. Directors are required by law to exercise discretion and independent judgment in the best interests of the company. All directors (whether executive or non-executive) must bring their own objective judgment to bear on board decisions.

The 'independence' of directors is not defined in the Corporations Act 2001 (Cth) (Corporations Act). The ASX CGC's Principles define an independent director as a NED who is not a member of management, and who is free of any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the independent exercise of their judgment.[26]

In the case of ASX-listed entities, the ASX CGC's Principles list a number of relationships that are considered to possibly affect the independence of a director. These include, for example, if the director is a substantial shareholder, employee, material professional advisor or consultant, material supplier or customer of the company or has a material contractual relationship with the company.[27]

In contrast, APRA has adopted a stricter approach to assessing independence of directors, and explicitly states that particular circumstances (adapted from the ASX CGC's Principles) will not meet its test of independence.[28] Under APRA's standards a director who falls into one of its stated categories cannot be independent. The circumstances listed by APRA are not exhaustive so a director may not be independent despite not falling into any of the categories listed.[29] If the board of an APRA-regulated institution is in doubt regarding a director's independence, the regulated institution may refer the matter to APRA for guidance.

To ensure that the board exercises independent judgment, the ASX CGC's Principles recommend that:

- a majority of the board comprise independent directors;[30]
- the chair of the board be an independent director;[31]
- the chair and the CEO not be the same individual;[32] and
- a board disclose in its annual report the directors it considers are independent and, if it considers a director to be independent notwithstanding the existence of a specified relationship, to state its reasons for holding this view.[33]

In the case of APRA-regulated entities, APRA's governance standards also require boards to comprise a majority of independent directors and have an independent chair who has not been the CEO of the regulated entity at any time in the previous three years.[34]

Boards should regularly assess whether each NED is independent, and each NED should provide all information that may be relevant to this assessment. If a NED's independent status changes, this should be disclosed to the market.[35]

Larger listed companies tend to have a higher proportion of independent directors than smaller listed companies. In 2009, ASX 300 company boards, on average, were comprised of just over half independent directors, with larger ASX-listed companies having a higher proportion of independent directors.[36] In 2008, only 45 per cent of all listed companies indicated that their boards comprised a majority of independent NEDs.[37] Generally, companies that did not have a majority of independent NEDs reported that this was due to their relatively small size, lack of resources or that the experience and skills of non-independent directors were appropriate.[38]

It may not always be appropriate for a company to have a majority of independent directors on its board. For example, it may be more valuable in a small start-up company for the directors to have company-specific expertise rather than be independent.[39] However, in a larger, more mature company, it may be more appropriate for the board to consist of a majority of independent directors to assist with independent monitoring of the company and its strategy.[40]

While it is generally thought that increasing the proportion of independent directors on a board will improve company performance, the evidence from academic research is equivocal.[41]

Board committees

As board matters become more complex and demands on a board's time increase, boards are increasingly delegating matters to specialist board committees. This allows certain board members to focus on specific aspects of the board's responsibilities in more detail than it is possible to do in a full meeting. It also assists with sharing the board's workload and making more effective use of directors' time.

A 2009 survey of Australian directors across a range of companies found that the audit committee is the most frequently occurring board committee (with 62 per cent of all boards and 80 per cent of public company boards having an audit committee), the remuneration committee is the second most common (with 21 per cent of surveyed boards having a remuneration committee) and the nomination committee being the third most frequently occurring (with 12 per cent of surveyed boards having a nomination committee).[42] Other common committees include the corporate governance, risk, investment, finance, and health, safety and environment committees.

In the listed company space, the ASX CGC's Principles recommend that boards establish:

- a nomination committee (Recommendation 2.4). (The use of a nomination committee is discussed in more detail at the end of this chapter.);
- an audit committee (Principle 4). This is also a requirement under ASX Listing Rule 12.7. If the company was in the ASX 300 index at the beginning of its financial year, then it must (in accordance with ASX Listing Rule) follow the recommendations of the ASX CGC's Principles on the composition, operation and responsibility of the audit committee; and
- a remuneration committee (Principle 8). From 1 July 2011, the ASX Listing Rules require all entities in the ASX 300 index to have a remuneration committee comprised solely of NEDs to advise that entity on matters relating to the remuneration of its key management personnel (new ASX Listing Rules 1.1 (condition 16) and 12.8).

According to a survey conducted in 2010, 100 per cent of ASX 50 and 97 per cent of ASX 300 companies have an audit committee; 100 per cent of ASX 50 and 89 per cent of ASX 300 companies have a remuneration committee, and 64 per cent of ASX 50 and 30 per cent of ASX 300 companies have a nomination committee.[43]

The ASX CGC's Principles provide helpful guidance in relation to the purpose, composition, structure and roles and responsibilities of each of these committees. The Australian Institute of Company Directors has also published helpful guides in relation to audit committees and remuneration committees (see *Suggested further reading* at the end of this publication).

Regular evaluation of a committee's charter will ensure that it is fulfilling its objectives and that the board as a whole is maintaining its overall responsibility for decision making.

Board size

The Corporations Act sets the minimum number of directors which must sit on a proprietary company or public company board. As a minimum:

- a proprietary company must have at least one director who must ordinarily reside in Australia;[44] and
- a public company must have at least three directors (not counting alternate directors), two of which must ordinarily reside in Australia.[45]

A board should be of a size and composition that is conducive to making appropriate decisions.[46] The board should be large enough to incorporate a variety of perspectives and skills, and to represent the best interests of the company as a whole rather than of individual shareholders or interest groups. It should not, however, be so large that effective decision-making is hindered.[47] Too many directors can cause a board to be inefficient because discussions become quite lengthy and it can be difficult to reach agreement. The size of the board is usually related to the size of the company. A large public company will often have between 8 to 12 directors, depending on its size. In the case of statutory corporations, the size of the board will often be set out in the law establishing the relevant organisation.

In Australia, the ideal board size is considered to be around 8 to 10 members.

Larger boards are considered to be less manageable – however talented the chair – inhibiting the ability of individual directors to contribute.[48] When boards are composed of more than 12 people, research in the UK suggests that a number of skills are compromised, namely, attention span, the ability to deal with complexity, the ability to maintain effective inter-personal relationships and motivation.[49] Research also suggests that large boards can lead to passive 'free riding' (directors who believe their underperformance will go unnoticed or unmeasured, or that other directors will pick up their slack), dislocation and 'group-think' (whereby group members try to minimise conflict and reach consensus without critically testing, analysing and evaluating ideas), thereby reducing the ability of the board to effectively monitor senior management and govern the business.[50] A bigger threat is board cohesiveness being undermined over time if having too many directors makes it a struggle to reach consensus and leads to board factions.[51]

Experienced company chair, John Schubert FAICD, has commented on this issue as follows:[52]

> The dynamics of the discussion at any meeting deteriorate with every addition above six or seven participants, but with a major company, you probably need a minimum of nine or 10 people to cover the skills and experience needed and to populate the various board committees. That means the dynamics are not ideal.
>
> Directors might find themselves thinking: "I won't say that because the discussion has already gone on long enough" when, in fact, the comment they dismissed could have triggered a new train of thought which proved to be the most important conversation of the day. And, it's not as simple as prolonging the discussion; every hour very senior management spend at the board meeting is taking them away from running their businesses and that's a loss.

There is no escaping the need to compromise, so you need to be very sure the pluses of adding an extra board member offset the negatives of less effective communication.

A common reason often given for a large board size is to facilitate the board's resource-gathering. A larger number of directors, it is believed, will translate into more strategic relationships that may be useful in procuring customers, clients, credit and supplies, and other resources.[53] This is not, however, the proper function of a board. Another suggested advantage of larger boards, in theory at least, is more collective information, a broader range of skills and more directors to do board tasks (including serving on board committees).[54]

In 2009, the median board size in Australia was six directors, which includes five NEDs and one ED, although this varied according to the company type (the median for public boards was six; private boards five; government boards seven; co-operative/credit union boards seven; and not-for-profit boards nine) and also company turnover.[55] Companies with the highest turnover tended to have larger boards.[56] In the listed company space, the majority of ASX 300 company boards (representing 41 per cent of such boards) comprised six to seven directors, whereas the majority of ASX 50 boards (representing 48 per cent of such boards) comprised eight to nine directors.[57] Different boards have different needs; however, current practice for listed companies in Australia tends toward a maximum of around 10 board members.

There can, however, be no general prescription as to optimum board size. Ultimately, the size of a board is a matter for each company, having regard to the nature and scope of the business of the company as well as its organisational structure, leadership style and needs. These needs will often change over time.

A charity, for example, may have a large board because it has diverse stakeholders or wants more directors to help management with networking and fundraising. A superannuation board may have a chairperson and 12 directors to ensure the right mix of member and employer representatives govern the institution on behalf of its investors. Boards of government enterprises could have similar requirements.[58]

As with board size, it is always dangerous being prescriptive on ideal board committee size when enterprises vary so much across industry and by location. Nevertheless, research in the UK suggests that to ensure quality thinking and effective interaction, the optimum size of a board sub-committee is between five and nine directors.[59] A group of five is said to become more of a team. With seven members, thinking is optimised. However, above nine, the ability of the cognitive limit of the group may be exceeded.[60]

Time commitment

Individual directors must be able to devote the necessary time required of them to perform their role and appropriately discharge their duties, including preparing for and attending board and committee meetings, attending plant or site visits, interstate and overseas travel, discussions with the CEO, ad hoc meetings, conferences and seminars, and participating in strategy days as well as continuing education and training. Directors need to regularly reassess the number and nature of their existing directorships and other demands on their time. In support of their candidature for directorship or re-election, directors should provide details of other commitments and an indication of time involved.[61]

The board or nomination committee should regularly review the time required from a NED, and whether directors are meeting that requirement. NEDs should inform the chair of the board (and the chair of any nomination committee) before accepting any new appointments as a director.[62]

The time commitment required of directors will vary: between different types of companies; over time depending on the particular circumstances of the company; and among board members (with the chair of the board needing to commit significantly more time than other directors). An estimate of the time commitment expected of directors should be clearly indicated in letters of appointment (discussed in Chapter 7 of this publication).

A survey in 2009 of Australian directors from a range of different types of companies found that the median time spent on board matters for each company of which they were a director:

- by a chair was 36 days per annum (the median of public company boards was 37; private company boards 25; government boards 50; co-operatives 50; and not-for profit boards 34); and
- by a NED was 24 days per annum (the median of public company boards was 27; private company boards 15; government boards 27; co-operatives 33; and not-for profit boards 20).[63]

The survey also found that the median time spent on board committee matters was six to seven days per year.[64]

The time commitment may be much greater than these figures, particularly for non-executive directors and chairs of large public listed companies. As Kevin McCann commented:[65]

> Being the non-executive chairman of a listed company is now a major commitment of time and energy. A chairman is expected to attend all board committee meetings and be a visible presence at the corporate head office. As a rough rule of thumb, the chairman of a top 20 company with international operations should expect to spend (on average) 20 hours a week on company business.

However, attendance at board and committee meetings alone is not determinative of a non-executive director's contribution to a board. As experienced company chair, Graham Bradley AM FAICD observed:

> The true value added by a director cannot be measured by time and attendance alone. One important insight might be more valuable than a year's attendance at board meetings. It is insights and judgment that counts, not hours clocked on.

Director tenure and board renewal

Board renewal is important in ensuring that a board continues to perform effectively over time. Board performance evaluations are critical to this exercise.

Many company constitutions specify a maximum number of terms that can be served by a director. While this encourages board renewal, it is important to keep in mind that it often takes a year or two for a director to learn the business well.

In the case of ASX-listed companies, directors (with the exception of the managing director) cannot hold office for more than three years without re-election.[66] The average tenure of NEDs on ASX 100 companies in 2009 was 6.1 years (up from 5.7 years in 2008 and 5.4 years in 2007).[67]

The board or its nomination committee should ensure that succession plans are in place to maintain an appropriate mix of skills, experience, expertise and diversity on the board at all times. Directors should be conscious of the duration of each board member's tenure when considering succession planning of the board.[68] This is discussed in further detail in Chapter 7 of this publication.

Director competencies

In order to discharge its duties effectively, the board should comprise directors possessing an appropriate range of skills and expertise.[69] The board or its nomination committee should consider implementing a plan for identifying, assessing and enhancing director competencies.[70]

Competencies for board members can be broken into 'job-related skills' necessary to perform their role as a director and 'personal qualities'. It is important to acknowledge that not all directors will possess each necessary skill or quality but the board as a whole must possess them.

While it will vary greatly between companies, the common job-related competencies sought on boards include:

- **strategic expertise** – the ability to review the business strategy through constructive questioning and suggestion;
- **accounting and finance** – the ability to read and comprehend the company's accounts, financial material presented to the board, financial reporting requirements and some understanding of corporate finance;
- **legal** – the board's responsibility involves overseeing compliance with numerous laws as well as understanding an individual director's legal duties and responsibilities;
- **managing risk** – experience in identifying areas of major risk to the organisation;
- **managing people and achieving change** – understanding the dynamics of people management in business or other relevant organisations;
- **familiarity with financial markets**; and
- **industry knowledge** – experience in similar organisations or industries.

The need for other skills, knowledge and experience will depend on the size and type of company and the markets it operates in.

While different directors will bring different technical skills and knowledge to a board, the following personal qualities are desirable in all directors:

- **integrity** – fulfilling a director's duties and responsibilities, putting the organisation's interests before personal interests, acting ethically;
- **business acumen**, commercial experience and sound judgment – good business judgment and acumen and instincts as well as an ability to get to the crux of an issue quickly;
- **curiosity and courage** – a director must have the curiosity to ask questions and the courage to persist in asking or to challenge management and fellow board members where necessary;

- **interpersonal skills** – a director must work well in a group, listen well, be tactful but be able to communicate their point of view frankly;
- **genuine interest** – a director must have a genuine interest in the organisation and its business;
- **an active contributor** – there is no room on boards today for those who do not contribute. Conversely, it is important that one director does not consistently dominate boardroom discussion.

An evaluation of the range of skills, experience and expertise on the board is important when considering new candidates for nomination or appointment. Such an evaluation enables identification of the particular skills that will best increase board effectiveness. Directors will be appointed to the board because their specific skills, knowledge and experience will be perceived to fill particular gaps on the board. This is discussed in more detail in Chapter 5.

ASX-listed entities are required (on an 'if not, why not' basis) to disclose in their annual report (amongst other things):

- the skills, experience and expertise relevant to each position of director; and
- a statement of the mix of skills and diversity that the board is looking to achieve.[71]

Boards should regularly review their composition as part of a formal process of evaluating the effectiveness of the board. A board should be structured in such a way that it:[72]

- has a proper understanding of, and competence to deal with, the current and emerging issues of the business;
- exercises independent judgment – all directors, whether independent or not, should bring an independent judgment to bear on board decisions;
- encourages enhanced performance of the company; and
- can effectively review and challenge the performance of management.

Improving board effectiveness

Research suggests that the following are necessary for effective board performance:[73]

- a boardroom culture of mutual respect, honesty and openness that encourages constructive debate;
- diversity of experience, styles, vocational backgrounds and also age, gender and cultural backgrounds;
- a good relationship with the CEO and senior management;
- a common sense of purpose and strategic clarity;
- an experienced chair who can manage the board agenda, encourage debate and work effectively with the CEO; and
- efficient board structure and processes including committees, board papers, information flow and a good company secretary.

The same research suggests that the factors which can hinder board effectiveness include the opposites:

- an adversarial atmosphere in the boardroom or an unmotivated board with a tendency for 'group-think';
- skill deficits or lack of genuine independence on the board;
- a poor relationship with the CEO and senior management which can impede information flow;
- conflicts of interest or factional interests on the board, perhaps due to a dominant shareholder;
- a poor chair who is too weak, too autocratic or too close to the CEO; and
- poor processes leading to inefficient use of time.

A board should monitor the effectiveness of its performance by regularly reviewing its composition, governance relations and internal processes. Additionally, it should ensure that directors have access to relevant training and development.

Cultural issues are as important as structural and procedural issues. A lack of trust, respect and engagement amongst directors can impact on the board's effectiveness. The chair's role is to harness the skills, qualities and resources of the board and to guarantee that issues of personality and style do not interfere with the board's work.

Board selection

Boards should proactively consider their selection practices and whether current approaches:

- are in line with best practice;
- reflect the current needs of the board; and
- take into account diversity issues.

Some Australian companies are not searching broadly for talent, or have not done so in the past. As a result of traditional selection and recruitment practices, often informal in nature and relying on personal networks, many directors have been selected from relatively narrow pools of people sharing common experiences, career patterns and backgrounds.[74] Consequently, many boards lack a diverse range of skills, experiences and perspectives that could help them address the diverse challenges confronting their companies.[75]

These matters will be covered in the following chapters of this publication.

All boards should provide transparency around the processes adopted in searching for and selecting new directors to a board. Companies are also encouraged to report to shareholders on their board selection and nomination processes. Such reporting should include, for example:

- details as to whether the company develops a board skills matrix and uses this matrix to identify any 'gaps' in the skills and experience of the directors on the board;
- the process by which candidates are identified and selected including whether professional intermediaries are used to identify and/or assess candidates;
- the steps taken to ensure that a diverse range of candidates is considered; and
- the factors taken into account in the selection process.

Following submissions made by the Australian Institute of Company Directors to the ASX CGC,[76] the above suggestions have now been incorporated into the ASX CGC's Principles.[77]

In the case of listed entities, the ASX CGC's Principles recommend that such entities post on their website in a clearly marked corporate governance section, a description of the procedure for the selection and appointment of new directors and the re-election of incumbent directors and the board's policy for the nomination and appointment of directors.[78]

A formal and transparent selection procedure helps to promote greater investor understanding and confidence in that process.

Use of nomination committees

A board nomination committee can be an efficient way to assist boards with the selection and appointment of new directors, though ultimate responsibility rests with the full board.[79]

The responsibilities of a nomination committee often include making recommendations to the board about:[80]

- the necessary and desirable competencies of directors;
- board succession plans;
- the development of a process for evaluation of the performance of the board, its committees and directors; and
- the appointment and re-election of directors.

In the case of listed entities, the ASX CGC's Principles suggest that boards of listed entities have a nomination committee comprising at least three members, a majority of whom are independent directors including an independent chair.[81] It is common for the chair of the board to also chair the nomination committee.

In some companies, all of the directors on the board are members of the nomination committee. For example, all of the directors of QBE Insurance Group sit on its nomination committee. This is because the board considers that its composition, including selection, appointment, renewal and retirement of members, to be of such importance that it is the role of the entire board as a whole to be involved.[82]

For smaller boards, it may not be efficient or appropriate to have a formal nomination committee. Companies without a nomination committee should nevertheless have board processes in place that consider the issues that would otherwise be considered by a nomination committee.[83]

Approximately half of Australia's top 400 listed public companies (by market capitalisation) reported in 2008 that they had a separately constituted nomination committee.[84]

When composing a nomination committee, it is important to consider the diversity of the committee including gender diversity for the reasons discussed in Chapters 2 to 4 of this publication. Research conducted by the Australian Institute of Company Directors in 2011 on the composition of nomination committees in the ASX 200 found that women comprise only 9.3 per cent of nomination committee members.[85] This is in contrast to the US where women chair 16.9 per cent of all nomination committees of Fortune 500 companies.[86]