AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS

DIRECTOR TOOLS

Selecting a new director

Board composition

The ASX Corporate Governance Council's ('ASXCGC') *Corporate Governance Principles and Recommendations 3e* (2014) ('ASX Principles') state in Principle 2 (*Structure the board to add value*) that:

> *"A listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively."*

A board needs to have directors who possess a broad mix of skills and experience to be effective.

The key goal in selecting directors is to build a mix of individuals that can work as a well-rounded team. A formal and transparent procedure for the selection, appointment and re-appointment of directors to the board helps promote investor understanding and confidence in that process. It can be difficult to remove a poor choice of director, so it is worth investing in the process. A well-perceived appointment can enhance a company's reputation and market standing, which may have flow-on effects for the organisation such as easier access to finance.

What are general key competencies for directors?

There is no absolute list of competencies that apply to all boards. Each board must review its own special requirements. The competencies required will be impacted by a number of factors:

- Size of the board
- Committee structure of the board
- Whether the organisation is for-profit, not-for-profit or a government instrumentality
- Size, nature and financial position of the company
- The organisation's strategy
- Complexity of operations – lines of business, geographic spread of operations, etc
- Shareholder/member structure
- The competencies of senior management
- Risks and challenges of the business

However, there is one competency which following the Centro case[1] it is considered that all directors should possess – sound financial and accounting knowledge. This means the ability to read and comprehend the company's accounts, financial material presented to the board, financial reporting requirements and an understanding of corporate finance. In the Centro case, Justice Middleton made the observation that this is a key requirement that a director cannot delegate to other directors, board committee, advisors or management.[2]

Other competencies which are considered to be important for many boards include:

- **Strategic expertise** – the ability to understand and review the strategy;
- **Legal** – the board's responsibility involves overseeing compliance with numerous laws as well as understanding an individual director's legal duties and responsibilities;
- **Risk management** – experience in managing areas of major risk to the organisation;
- **Managing people and achieving change** – including experience as either a CEO or senior member of a management team in a similar or larger sized organisation;
- **Industry knowledge** – experience in similar industries.

What personal qualities should board members have?

While different directors can bring different technical skills and knowledge to a board, there are personal qualities that are desirable in all directors:

- **Integrity** – fulfilling a director's duties and responsibilities, putting the organisation's interests before personal interests, acting ethically
- **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 able to communicate their point of view frankly
- **Genuine interest** in the organisation and its business
- **Instinct** – good business instincts and acumen, ability to get to the crux of the issue quickly
- **An active contributor** – there is no room on boards today for those who do not contribute

Commentators also suggest that directors must ensure they have adequate time to devote to the organisation's affairs.

How does a board analyse its specific needs?

The board is responsible for ensuring that the skills, knowledge and experience needed to effectively steer the organisation both now and in the future are represented on the board. An analysis of the current board's skills and experience in relation to organisational strategy and future goals will help in identifying gaps in knowledge and targeting selection criteria. Directors should be appointed for their special skills and knowledge that will assist with the issues and opportunities the company is facing.

This is done using a board skills matrix. In a board skills matrix the board sets out the specific skills it requires. These skills include industry related competencies, specific technical skills such as accountancy or legal, specific work-related experience such as being a CEO or risk manager, governance related skills such as having completed the AICD's *Company Directors Course*, diversity attributes and behavioural skills. The skill set of exiting directors is then mapped against this matrix, identifying any current gaps as well as allowing a specification for new directors when a vacancy arises. The ASXCGC's Recommendation 2.2 now makes this a specific recommended requirement for all listed companies.

[1] *ASIC v Healey* (2011) 196 FCR 291; [2011] FCA 717.
[2] *ASIC v Healey* (2011) 196 FCR 291; [2011] FCA 717 at 174-175.

"The desired time commitment must also be quantified. The board should consider the number and nature of other directorships and commitments that a potential director has to ensure that they can effectively fulfil their legal duties and responsibilities for this organisation."

If an organisation has special needs or exposure to a particular stakeholder group, it makes sense to include a director who has experience in that area. For example, a company that spends a great deal of time doing business with government may need someone with first hand experience of the political process. This will be included in the skills matrix.

The board's needs will alter as an organisation reaches a new stage in its lifecycle. Therefore, when defining needs, consider where the organisation is heading as well as where it is now. Expanding operations into new product/service or geographic areas, planning acquisitions, staving off a growing competitive threat etc, will impact on the skills and knowledge required by the board.

The desired time commitment must also be quantified. The board should consider the number and nature of other directorships and commitments that a potential director has to ensure that they can effectively fulfil their legal duties and responsibilities for this organisation.

The board should also review the provisions in the organisation's board charter, which may have a bearing on the selection of directors, and the constitution, which will outline appointment procedures.

Listed companies have additional considerations, such as complying with the requirements of the ASX Principles. For instance, these principles recommend that the majority of the board be independent and that the board consider diversity as a key component of its skills matrix. In addition, for listed entities the ASX Listing Rules now require that each director is of 'good fame and character.'[3]

Financial services companies (including banks, building societies, credit unions, life and general insurers, friendly societies) also face special requirements from their regulator, the Australian Prudential Regulation Authority (APRA). These requirements are outlined in APRA's Prudential Standards on 'Governance' (for example CPS 510) and 'Fit and Proper' (for example CPS 520).

Finally, under the Australian Charities and Not-for-profits Commission (ACNC) Governance Standards, registered charities are required under standard 4 to ensure that 'responsible persons' (such as board or committee members or trustees) are not disqualified from managing a corporation under the *Corporations Act 2001* (Cth) or disqualified from being a responsible person of a registered charity by the ACNC Commissioner.[4]

---

[3] Australian Securities Exchange, 'Chapter 1: Admission', *ASX Listing Rules*, 22 September 2014, Listing Rule 1.1, condition 17, [www.asx.com.au/documents/rules/Chapter01.pdf].

[4] *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth), s 45.20.

What are the gender diversity requirements for listed companies?

Diversity of membership of a board is acknowledged as an important element in achieving a balance of ideas. While diversity covers a range of human attributes, the major type of diversity currently discussed in contemporary corporate governance is gender diversity. Regarding gender diversity, the percentage of women serving on boards worldwide remains low. In Australia, the percentage of women on boards of ASX 200 companies and the proportion of women comprising new appointments increased significantly in recent years. At 30 November 2015, the percentage of women on ASX 200 boards was 21.5 per cent.

For listed companies, the third edition of the ASX Principles requires companies to establish a diversity policy that includes measurable objectives in relation to gender diversity. Companies are required to report their achievements against their measurable objectives on gender diversity in their annual report.
The specific requirements of Recommendation 1.5 are:

> *"A listed entity should:*
>
> *(a) Have a diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving gender diversity and to assess annually both the objectives and the entity's progress in achieving them;*
>
> *(b) Disclose that policy or a summary of it; and*
>
> *(c) Disclose as at the end of each reporting period the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with the entity's diversity policy and its progress towards achieving them, and either:*
>
> *(1) The respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined 'senior executive' for these purposes); or*
>
> *(2) "If the entity is a 'relevant employer' under the Workplace Gender Equality Act, the entity's most recent 'Gender Equality Indicators', as defined in and published under that Act."*

While only applying to listed companies, many other boards of large organisations have adopted similar diversity policies and are conscious of the need to ensure gender diversity, among other types of diversity, on their boards.

" While diversity covers a range of human attributes, the major type of diversity currently discussed in contemporary corporate governance is gender diversity. Regarding gender diversity, the percentage of women serving on boards worldwide remains low."

What does a nomination committee do?

Many larger organisations have established a board nomination committee to manage succession planning for the board and executives.[5] This ensures that a list of potential candidates relevant to the organisation's strategy and future goals is always on hand. The committee's responsibilities will be outlined in a charter and will usually include identifying strengths and weaknesses, skills and experience gaps in advance of anticipated vacancies such as retirements and preparing strategies to improve the board.

The ASX Principles provide good guidance on the role of a nomination committee. Recommendation 2.1 recommends that listed companies establish a nomination committee. They see the committee's role as:

> *"being to review and make recommendations to the board in relation to:*
>
> - *board succession planning generally;*
> - *induction and continuing professional development programs for directors;*
> - *the development and implementation of a process for evaluating the performance of the board, its committees and directors;*
> - *the process for recruiting a new director, including evaluating the balance of skills, knowledge, experience, independence and diversity on the board and, in the light of this evaluation, preparing a description of the role and capabilities required for a particular appointment;*
> - *the appointment and re-election of directors; and*
> - *ensuring there are plans in place to manage the succession of the CEO and other senior executives."*

While a nomination committee is not essential in smaller or non-listed organisations, many larger non-listed organisations find that they most helpful to undertake what can be a demanding workload.

How does a board find candidates for a board position?

In the past, boards have typically relied on their informal networks to find suitable candidates to fill board positions. The demand for accountability is now making the selection of directors more open and transparent. Boards can no longer rely on personal networks and retiring senior executives from their own industry to provide the range of skills and experience they need. A good professional search firm will suggest candidates from further afield. The issue of using search firms is discussed further below.

How to deal with shareholder request for board seat?

There have been recent prominent examples of a shareholder seeking a seat on the board. Often in Australian companies, a shareholder with 15 per cent or greater ownership will get a seat on the board. However, there are examples when a board has rejected such a shareholder where it is not considered to be in the best interests of the company as a whole.

Usually, the shareholder will approach the chair of the board and then the matter is discussed by the board as a whole. The board can appoint the proposed director and then endorse his or her election at the next annual general meeting. If this does not happen, any shareholder with 5 per cent of a public company can requisition an extraordinary general meeting to consider the position of directors.

For a discussion of shareholders on the board and ten tips for boards in dealing with shareholder requests for board seats, see 'Taking a shareholder on board.'[6]

---

[5] The ASX *Corporate Governance Principles and Recommendations* acknowledge that it may not be efficient for a small board to establish a nomination committee. Companies without a formal nomination committee should ensure they have other processes in place to raise the issues that would otherwise be considered by a nomination committee.

[6] Featherstone, T., 'Taking a shareholder on board', *Company Director*, September 2012.

" A key feature of an effective board is independence of mind. A board full of directors always agreeing with each other will not function efficiently."

What is the Australian Institute of Company Directors 'Directorship Opportunities'?

The Australian Institute of Company Directors has developed a customised program to better assist members looking for directorships and connecting them with organisations seeking board members. This directorship search service has been designed to specifically address the issues of greater visibility and control over finding new directorships on Australia's private, public and not-for-profit boards.

Should search firms and specialist recruitment consultants be used?

Boards may find search firms useful when seeking a new director with the right skills and experience for their business. Search firms can make recommendations from a huge array of contacts, from highly experienced directors to new directors with a breadth of practical experience. They can introduce candidates whom the board might not have considered and can increase success in finding a director with the right skills.

However, the use of such advisors depends on the nature of the business and the skills that are needed on the board. If a search firm is used, the board must actively manage the involvement of the search firm in the process. Boards will either use the nomination committee, if one exists, or appoint a small group of directors to liaise with the search firm and then in conjunction with the firm to develop the initial list of potential candidates to a short list of three to five persons. The whole board should be involved in the selection of the final person. The search firm can then do a thorough background check to ensure that the person has not embellished their curriculum vitae and meets any other requirements, as set out below, required by the board.

While very valuable, these services can be very expensive and may be beyond the reach of SMEs and smaller not-for-profit boards.

Should personal networks be used?

Personal networks can be a valuable source of information about potential candidates. The chief advantage of using a network is that there is first-hand knowledge of a candidate's working style. This will assist in determining whether a director will be able to work in a collegial manner with other directors.

Caution is needed, however, to ensure that the board is not filled with 'mates'. A key feature of an effective board is independence of mind. A board full of directors always agreeing with each other will not function efficiently. The board must be comprised of people who fill a defined need, challenge the status quo, ask appropriate questions and are persistent in getting answers. Just relying on the contacts of exiting directors has been identified as a major reason for the historic lack of diversity of many boards of major companies.

Should the board do background checks?

As mentioned above, there are now standards which are required of directors of different classes of companies such as listed companies and charities. Also given the legal responsibilities that directors face and the collegial nature of an effectively functioning board, directors must trust and respect each other. Therefore, it is advisable to substantiate information provided by a candidate about themselves.

Some people are unable to act as a director. This includes people who are undischarged bankrupts or who have been convicted of certain types of offences.[7] The court also has discretion to disqualify individuals from being directors if the individual breaches certain civil penalty provisions of the *Corporations Act 2001* (Cth).[8]

As a starting point, boards should devise a policy on selection and appointment procedures that includes the minimum level of background checking the board views as necessary. For larger organisations using a search or recruitment firm, part of the firm's brief will include an instruction to verify the CV's information to the level suggested by the policy statement.

Smaller organisations can use a variety of free or fee-based services to confirm information. At a minimum, they can check information with the Australian Securities and Investments Commission (ASIC) using the sources below, speak with the candidate's referees and verify employment dates.

Free sources on ASIC's website through ASIC Connect include:

- National Names Index – an index of registered companies in Australia;
- Register of Banned or Disqualified Persons.

" A key feature of an effective board is independence of mind. A board full of directors always agreeing with each other will not function efficiently."

ASIC also has an Enforceable Undertakings Register, which can be searched online.

Note that there are limitations on the information offered by each of these searches.

An ASIC Service Centre or an information broker listed on ASIC's website can, for a small fee, search on a director's name and provide a list of all their directorships and terms of office.

People are disqualified from managing corporations if they are insolvent. The Insolvency and Trustee Service Australia (ITSA) maintains the National Personal Insolvency Index (NPII) and this can be searched through information brokers listed on their website, again for a small fee.

The ACNC also maintains a list of disqualified 'responsible persons' which can be accessed at the ACNC Register of Disqualified Persons. However, at February 2016 no person has yet been disqualified by the ACNC.

It is also becoming more widely accepted for police checks to be conducted for a potential director. In addition, if the organisation involves work with children, it is possible that special working with children clearance will be required. Potential directors should be advised that these background checks will be undertaken and their approval, in writing, sought before the enquiries are made.

[7] Under s 206B of the *Corporations Act 2001* (Cth), an individual is automatically disqualified from being a director if they have been convicted of certain types of offences. These include offences involving dishonesty which are punishable by at least 3 months imprisonment and offences involving a contravention of the *Corporations Act* which are punishable by imprisonment for greater than 12 months.

[8] Under s 206C of the *Corporations Act 2001* (Cth), the court may disqualify a person from being a director if the person has breached certain provisions of the *Corporations Act* and the court is satisfied that disqualification is justified.

What areas should a board consider when reviewing potential candidates?

- Does the candidate have skills that would add value to the board or fill a gap?
- Does he or she understand the organisation's business?
- Can the candidate work as part of this team of directors?
- Does he or she have sound business instincts and judgment?
- Does he or she have a proven track record?
- Is the candidate genuinely interested in the organisation, its business and people?
- Is the candidate honest and a person of integrity?
- What other directorships and commitments does the candidate have?

How does a board communicate its expectations to new directors?

Executive directors will normally receive and sign an executive service agreement or contract. Non-executive directors generally receive and sign a letters of appointment. Examples of current good practice are provided by the ASXCGC in this area. Recommendation 1.3 states that:

> *"A listed entity should have a written agreement with each director and senior executive setting out the terms of their appointment."*

Recommendation 2.6 states:

> *"A listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed to perform their role as directors effectively."*

About us

The Australian Institute of Company Directors is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership includes directors and senior leaders from business, government and the not-for-profit sectors.

For more information **t:** 1300 739 119 **w:** companydirectors.com.au

05446-1_16