THE ROLE AND FUNCTIONING OF THE BOARD
Objectives
By the end of this session, participants will be able to:

• Describe the Board’s role in formulating a strategy for sustainability

• Differentiate between directing and managing

• Explain how board composition, structures, processes and evaluation strengthen corporate governance

• Analyze interests and options in a board conflict case
The Overview of the Board’s Role

**Oversight**

- Risk oversight
- Control/monitor performance
- Internal/external audit policies
- Approval of investments, mergers and acquisitions

**Value Creation**

- Risk management
- Strategy formulation
- Create code of conduct (e.g. values, behavior, conflict resolution)
- Protection of shareholder rights

**Financial Oversight**

- Evaluation of management performance
- Compensation guidelines
- Approval of HR policies
- Succession planning

**Ethics/Duties**

- Basic organizational design (e.g. dominant axis of management, relations between holdings and subsidiaries)

**Human Resources**

- Board roles, committees
- Board policies, proceedings
- Information needs Reporting lines
- Board calendar, Meeting agendas

**Organization**

- Protection of shareholder rights

**Protection of shareholder rights**
Board Role: Different Perspectives

**Practical View**
- The job of the board is not clearly defined in the mind of the general or even business public.
- One can actually observe different opinions about the role of the board around this same broad table.
- Very few boards pay conscious attention to this issue by asking themselves explicitly what they see as their role.

**Legal View**
- Corporate law is not very clear on the definition of the board’s work.
- It leaves ample room for choice of agenda and the degree of involvement in the tasks that have been named.
- The law is often behind the practical developments.
- There are frequently substantial discrepancies between the de-jure and the de-facto role of the board.

**Advice**
A board should regularly question the role it wants to play - deeply involved or passive. The contribution of the board must be: *Distinctive* (i.e., nobody else in the corporation does it) and *Additive* (i.e., the involvement of the board makes the decision better and/or prevents that the company is exposed to unacceptable risks).
Board Role in Strategy Formulation

**Deliberate & Approve Strategy**  
_set tone at the top_

- Approve Policies
- Clarify roles & responsibilities
- Monitor developments and key indicators
- Oversee Progress
- Revise, Adapt as needed

**Proactive** preferable to Reactive
How Should a Board Engage in Strategy?

Strategy preparation:
• Serve as early awareness system, bring objective perspective
• Formulate the most important, unsolved questions
• Set the agenda and process milestones

Strategic decisions:
• About (product and regional) portfolio, evolution of the business model (before defining specific objectives, actions and key performance indicators)
• Crucial choices of priorities, restructuring needs, risk levels in dialogue with management

Strategic planning (here management is clearly in the lead)
• Review and approve plans, budgets and milestones

Strategy implementation
• Review results and management performance
• Transfer the learning into corrections or new initiatives
Red-Flags on Board and Strategy

- Strategy and internal capacity do not correspond to one another
- Functional, business and corporate strategy do not feed into one another
- High productivity, poor performance
- Strategy has not been on the agenda for 6 months
- Major change in external factors does not lead to change strategy proposals by the management
The business case for sustainability is often found in efficiency gains and in health and safety improvements.
Defining Sustainability

Ensuring long-term business success while contributing toward economic and social development, a healthy environment and a stable society.

1. Dimensions of sustainability:

2. Economic / Financial

3. Environmental

4. Social
The IFC’s Perspective on Sustainability

• Improves competitiveness in a dynamic, global context

• Builds reputation; reduces reputational risks; can be a business driver for customers and investors

• Can save operating costs through better resource efficiency

• Mitigates potential costs associated with environmental mishaps

• Mitigates potential conflicts with communities, and thus business slow downs or lost productivity

• Broadly accepted comprehensive standards – global benchmark/seal of approval
Power Dynamics: Directing versus Managing

“Why isn’t corporate governance working better?

The answer lies in the relationship between the CEO and the board. Far too many CEOs seek to maintain power over their board and don’t really want to be challenged... This is a big mistake. Nor do I want a CEO who is totally dominated by their board members. What is needed is a balance in power between the CEO and the board...”

William W. George

Basic hypothesis: Checks and balances are desirable.

Power relationships are influenced by:

• Life cycle of company
• Type of business
• Life cycle of personalities
• Business strategy
• Business environment
The Chairman and The CEO

**The Chairman should**

- Ensure that the board is engaged and committed via strategy formulation
- Chair at board and shareholders meetings; set the agenda, facilitate constructive deliberations (& dissent)
- Involve all directors in discussions and decision making
- Take a lead role in determining governance structures and processes
- Ensure the board receives proper information
- Ensure links between board, shareowners and stakeholders
- Draw clear line between board and management responsibilities

**The CEO should**

- Ensure that the company as a whole is running with motivated staff
- Oversee operations of organization, manage human and financial resources
- Formulate policies and planning recommendations with the board
- Support board by providing timely information and interfacing between board and staff
- Ensure link among company, community and stakeholders
- Draw clear line between boards and management’s responsibilities
Red Flags - Board Oversight

- Indications of “creative accounting” to hide results
- Management overconfident and over-optimistic
- In-transparent changes in strategy
- External excuses by management for low performance
- Too high satisfactions with status quo, when successful
- Management divided over strategy

Advice

Each year, plan an off-site strategy formulation meeting with senior management.
CASE: Banco Navarra I – Board Conflict Over Strategy

• Read the case

• Pair or three-group analysis of the case
  • Summarize the situation, from Carlos’ perspective:
  • What are DFI’s interests? Others’ interests? CG concerns?

• Table groups: Identify CG issues (2-3)

• Report to whole group & discuss

• E-vote and discuss
Coffee/Tea Break
Polling Question:
If you were Carlos, what would you do at this stage?

0% A. Consult with the nominating shareholder.
0% B. Resign.
0% C. Request a pre-board meeting with the Chairman and CEO.
0% D. Discuss concerns with the audit committee.
0% E. Propose that the Board hold a special meeting to discuss this issue.
### Three Elements of Board Composition

#### Selection of board members
- What to look for
- Who should find them
- How to keep them

#### Evaluation of board members
- Do the existing (individual) members perform well?
- Does non-performance have consequences?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>Knowledge</th>
<th>Independence</th>
</tr>
</thead>
</table>
| • Overriding quality for board members  
  • Essential attribute of leadership affecting tenure of board members  
  • Demonstrated through principled action and effective communication skills | • Thorough knowledge of the world of business and management  
  • Depth of understanding of the company and industry  
  • Breadth of perspective of the environment related to the business  
  • Broadly based board member as “all purpose weapon” | • Has gained significance not without controversy (definition, role, performance)  
  • Definition:  
    • Provides no other services to company  
    • Is not employed by a firm providing major services to the company  
    • Has never been employed at this company |
### Diversity in the Boardroom

#### Why
- Reduce “group think”
- Increase the available amount of information and experiences for better decisions
- Tap into new pools for competent board members

#### Prerequisites
- May require mentoring
- CG education (this is especially relevant for developing countries with their very limited pool for independent directors)

#### What
- Gender
- Industry experience
- Professions
- Nationalities/cultures
- Age

#### Challenges
- Biases and inflexibility
- Need to create a trusting, open board climate
- Develop shared goals - to come to common decisions

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Do not impose too many quotas as it might be impossible to find that mix of competent board members due to limited availability.

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Advice

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Image: [International Finance Corporation (IFC)](https://www.ifc.org)
## Fundamentals of Board Committees

<table>
<thead>
<tr>
<th>General principles</th>
<th>Key benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Aid to the board, not substitution</td>
<td>• Delegation of functions and responsibilities to experts on the board</td>
</tr>
<tr>
<td>• Chaired by respected independent director</td>
<td>• Focuses the board on the “big picture”</td>
</tr>
<tr>
<td>• Only board directors on committees (maximum of two committees)</td>
<td>• Efficiency gains for the work of the board as a whole</td>
</tr>
<tr>
<td>• Focus on specialized areas of responsibilities, with clear agenda</td>
<td>• Quicker reaction and decisions through ad-hoc meetings in committees (and not as full board)</td>
</tr>
<tr>
<td>• Generally no executive powers</td>
<td></td>
</tr>
<tr>
<td>• Implications of co-option to consider</td>
<td></td>
</tr>
<tr>
<td>• For the board</td>
<td></td>
</tr>
<tr>
<td>• For individuals</td>
<td></td>
</tr>
<tr>
<td>• Clarify the committee mandate (terms of reference, limitations) in charter</td>
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</tbody>
</table>
Success Factors for Board Committees

- Make sure to have a clear mandate for the committee
- Have your own committee charter
- Have a clear committee agenda
- Select a suitable chairman
- Establish clear information-lines to the board
- Ensure that only board directors are on committees
- Ensure that board directors serve on a maximum of 2 committees
Red Flags of Board Committees

- Unclear responsibility split between the committee and the full board
- Unclear information channels to the full board
- Unsatisfactory information provided by management
- Dominant presence of management
- Unsatisfactory aptitude of committee members (e.g. independent members)
- Same directors on multiple committees
- Too little time for committee discussion
Overview of Board Meeting Processes

Frequency

Regular and frequent meetings provide board members with a significantly better information level.

There is a clear correlation between the perceived role of boards as a strategic influencing and the number of board meetings.

There is clear value in regular and frequent meetings. Exerting strategic influence requires a critical minimum of board meetings.

Seniority

Long-time board members show a better information endowment.

Information sharing among colleagues improves.

Board members see more easily through hidden agendas.

New board members need support in becoming efficient and effective - orientation program.

Request for information updates on key performance indicators and other relevant information also between board meetings.
Success Factors of Board Meetings

Create a climate of trust and candour

Share important information with directors in time for them to read and digest

Rotate board members through small groups and committees so they spend time together meeting key company personnel and inspecting company sites

Eliminate polarizing factions

Foster a culture of open dissent
• Do not punish mavericks or dissenters (they are not necessarily disloyal)
• Probe silent board members for their opinions and let them justify their positions
• Do not join a board where only conformity is asked

Utilize a fluid portfolio of roles
• Directors should not get trapped in rigid, typecast positions
• Develop alternative scenarios to evaluate strategic decisions
• Push to challenge roles and assumptions

Remember to be the “party pooper” at least once a year
ROLE OF CORPORATE SECRETARY

- Explains the procedural requirements of laws, the charter, and by-laws of the company
- Resolves organizational matters for board meetings
- Communicates with directors
- Oversees, conducts induction trainings for newly elected directors
- Communicates to and collects voting ballots from directors
- Establishes templates for preparing board papers & presentations
- Takes the minutes of board meetings
- Ensures compliance with the board procedures
- Notifies all directors of board meetings
Benefits of Board Evaluation

- Ascertain effectiveness of the board as a unit
- Obtain insights into board functions
- Define the role of board chairman
- Consider issues relating to reporting/information flow
- Test views on relations with management
- Assess board processes
- Identify any major areas of concern
- Seek consensus on board focus/priorities

Get the process started, even if it is just a small board evaluation. Use an independent facilitator.
Key Messages

• Board work is about value creation for the company and management oversight

• The division of labour between board and management is contingent on a variety of factors

• The board needs to allocate clear competencies and work division between board and management as well intra-board (e.g., in committees)

• Have a clear agenda for every board meeting within a coherent annual calendar
Thank you!
## Which Board am I Today?

<table>
<thead>
<tr>
<th>Low Involvement</th>
<th>High Involvement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Passive Board</strong></td>
<td><strong>Certifying Board</strong></td>
</tr>
<tr>
<td>At discretion of the GD</td>
<td>Certifies to SHs that GD meets expectations</td>
</tr>
<tr>
<td>Limited activity and participation</td>
<td>Takes corrective action only as ultima ratio</td>
</tr>
<tr>
<td>Limited accountability</td>
<td>Understands role of ind. Directors</td>
</tr>
<tr>
<td>Ratifies mgmt. preferences</td>
<td>Informed about GDs performance</td>
</tr>
<tr>
<td></td>
<td>Establishes a succession plan</td>
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</tbody>
</table>

Source: HBR, David A. Nadler, Building Better Boards
What Can the Board Contribute?

- Experienced, independent perspective
- Testing “obvious” assumptions and not so obvious beliefs
- Understanding based on involvement is the base for monitoring and asking the “right questions at the right time” (e.g., judgment call: ride out a market turbulence or correct midterm the strategy?)
- Assessment of the process: routine bureaucratic exercise or platform for strategic alignment and shared direction?
Isn’t Strategy the Prerogative of Management?

Yes, if you
- See it as a planning process leading to detailed budgets and operational targets and
- Are ready to ignore expectations of shareholders, regulators and employees

No, if you
- Hold the board accountable for the evolution and direction of the company
- Want commitment from the board for the strategy (commitment comes from involvement)
- Want consistency of decision-making, based on strategy alignment of board and management
- Do not see portfolio decisions and strategic bets as isolated decisions
Sustainability Encompasses

**Concern** for the well-being of future generations

**Awareness** of the multi-dimensional impacts of any decision
- economic, environmental, social

**Balance** across different dimensions
- Sectors: e.g., mining, manufacturing, transportation
- Themes: e.g., climate change, community cohesion, natural resource management
- Scale: e.g., local, regional, national, international

*The Sustainability Report*
Managing Risks: The Business Case

- **Employee**: Strike, Sabotage
- **Government**: Shutdown, Delay
- **Community**: Loss of license to operate
- **Shareholders**: Disinvestments
- **Financiers**: Increased Cost
- **Media**: Negative Publicity
- **Clients**: Contract loss, Boycott
- **NGOs**: Campaigns
- **Insurers**: Loss of Cover
- **Export Market Regulators**: Market Loss
Realizing Rewards: The Business Case

- **Employee**
  - Retention, Productivity
- **Government**
  - Renewal, Expansion
- **Community**
  - Operating License
- **Shareholders**
  - Long-term Investors
- **Financiers**
  - Reduced Cost
- **Media**
  - Reputational Benefits
- **Clients**
  - Stable Markets, Premium Pricing
- **NGOs**
  - Cooperation
- **Insurers**
  - Reduced Premiums
- **Export Market Regulators**
  - Open Markets
Difficult Struggle between Management and the Board Roles

Basic hypothesis: checks and balances are desirable

The balance is a dynamic balance - it can shift for a number of reasons, e.g.:
- Life cycle of company
- Life cycle of personalities
- Type of business
- Business environment
- Business strategy

The answer to the right power balance is difficult - it requires a good dose of judgment on both sides

“Why isn’t corporate governance working better? The answer lies in the relationship between the CEO and the board. Far too many CEOs seek to maintain power over their board and don’t really want to be challenged… This is a big mistake. Nor do I want a CEO who is totally dominated by their board members. What is needed is a balance in power between the CEO and the board…”

William W. George
Board Control

Does performance decline over time?

- Observing the novice
- CEO takes control
- CEO dominates
- Performance declines

$t$
Management Succession Planning

From inside the company

From outside the company

Before the contract of incumbent CEO expires

Orderly succession after the expiry of the contract of the incumbent CEO

Assuming the succession takes place orderly (after the contract of the incumbent CEO has expired)

There is need to recognize that there are widely differing starting positions possible when dealing with this issue
One-Tier vs. Two-Tier Boards

**One-Tier**
- Shareholders vote for the board of directors
- Both executive (inside) and non-executive (outside) directors are on the board
- To be found, e.g., in US, UK

**Two-Tier**
- Shareholders vote for supervisory board
- Supervisory board elects management board
- To be found, e.g., in Germany, Switzerland, France, Belgium

**Diagram**
- Shareholders vote in shareholders meetings
- Board of Directors:
  - Independent directors/outsiders
  - Executive directors/insiders (e.g. CEO)
- Supervisory Board
- Management Board
Other Important Criteria for Choice of Board Members

Specific Criteria:
Political or other influence
Gender (women on boards)
Bringing a foreign optics to the board (board members from abroad)
Being available time wise

Who should find new board members?
Question has impact on the board/management power balance
How many board members do we need? (size of board)
Questionable practices
Growing significance of nomination/corporate governance committees

Board members: How to keep them?
The role of the commitment and how to secure it
The letter of appointment
Firing the CEO

Is the CEO entitled to notice?

If dismissed without notice or unfairly, the company will probably be liable for remuneration.

The amount of remuneration will be subject to negotiation. The following factors are likely to weigh in the negotiation:

- The extent of any non-performance of duties
- Any loss that the director has caused the company
- The misuse of company property
- Whether the director has any shares in the company that he/she wishes to sell
- Whether the director has any loans from the company which must be settled
- The company’s cash flow position
- The desire of the company and the director to avoid publicity
- The company’s need to impose a restrictive covenant on the director to prevent him/her from working for a rival company
Typical Board Committees

Audit Committee
- Ensures the correct financial reporting and accordance to the law
- Ensures that IT reporting systems are in place
- Appoint and release company’s auditor
- Remuneration/Compensation Committee

Reviews and approves corporation’s pay and benefit policies and objectives
- Develop and identify performance-based criteria and goals to determine executive’s pay
- Ensures competitive compensation scheme

Nominating and Governance Committee
- Ensures best management resources
- Identify qualified candidates for the board
- Develop corporate governance principles and guidelines

Executive Committee
- Assist the board with its responsibilities concerning the management of the company
- Make strategy recommendations to board
- Exchange information concerning management issues between board and management
Questions to Ask before the Board Meeting

Does the agenda reflect the priorities, we need to address as a board? Are the most important, open questions first?

Is the information provided by management precise, comprehensive, but condensed enough to understand the issue and the decision asked for?

Do I have enough external information (independent from management) available for my judgement?

What are the topics, where I can add special value, given my knowledge and experience?

Where do I need to challenge management or the chairman, even to “stir the pot”?
Questions to Ask during and after the Board Meeting

Do I really listen to the others?

Are my contributions “on spot” (no more than 4 sentences) and grab the attention of the others?

Do I really focus on what is important for the outcome and in line, where I am competent – or just where I have an opinion?

Is the agenda (and time prioritization) followed? If not: for a compelling reason?

Do I challenge others, especially management, in a professional way, respectful but tough on the issue, keeping the personal relationship?

Is the work of the board committees sufficiently aligned with board priorities? Do I learn enough about their work and outcome? Do I communicate enough about the committees, I serve on?

Do I need to give feedback to the chairman or CEO regarding the flow of the session, their behaviour or the preparation?
Example of a Board Meeting Agenda

Approve minutes of last meeting

Approve routine matters requiring limited discussion

Operating and financial performance against business plan

Executives’ reports – business unit performance

Board committee reports

Discuss and approve material transactions
Example of a Typical Board Calendar

Standing items
- Approve meetings of previous meeting
- Approve unbudgeted capital expenditures over
- Review actual versus budgeted financial results
- Approve board committee reports

February
- 1 year assessment
- Dividend declaration
- Growth strategy discussion
- Strategy review

March
- Review financial performance versus competitors

April
- Authorization of foundation contribution
- Business plan review for next financial year

June
- Review/approve strategic plan
- Business unit No. 1 strategy review
- Review of chairman’s personal objectives
- Dividend declaration
- Annual meeting resolutions
- Set meeting schedule for next calendar year
- Litigation review

September
- Annual organization matters (committees, officer elections)
- Dividend declaration
- Annual shareowners meeting
- Review financial performance versus competitors
- Appoint external auditors

October
- Strategic plan review

December
- Approve annual budget
- Management development update
- Dividend declaration
- Strategy review
Best Practices in Drafting the Agenda

- The board chairman takes the lead
  - Coordinate with the committee chairs
  - Send draft agenda to other board members for comments
  - Allow corporate secretary to advise on procedural issues

- Order agenda items by importance

- Dedicate enough discussion time
  - Management presentations should make-up less than half of your time

- Educate directors to make their points directly and briefly

- Chairman sets timelines, enforced by corporate secretary
The Board Must Keep Minutes of its Meetings

Prepare within a short time after the meeting

Keep in the company archives

Approved by the board at the next meeting and signed by the chairman

Contain the following information
• Location and time of the meeting
• Names of the persons who participated in the meeting
• Agenda of the meeting
• Agenda items and the voting results (on an individual basis where there has been dissenting opinion)
• Description of decisions made by the board
• Make sure minutes are understandable and board decisions/instructions are communicated to management
Board Evaluation: Pros and Cons

Pros:
- Assessing individuals to determine issues relating to the group's effectiveness
- Identify underperforming directors through formal assessments
- Ability to act quickly (improve their performance or to remove)

Cons:
- Might undermine boardroom collegiality
- Difficulty to determine who should evaluate a director
- Danger of establishing standard evaluation criteria which might overlook the different ways members contribute

Typical board evaluations:
- Full board
- Committee
- Individual member
Board Evaluation Process

Criteria

The degree of accomplishment of the board’s normal responsibilities

The quality of the board-management relationship

The effectiveness of the board processes and meetings, e.g.:
- Quality of the discussions
- Credibility of reports
- Use of constructive professional conflict
- Level of interpersonal cohesion
- Degree of knowledge
- Initiatives, participation, energy levels of individual board members
- Directors’ confidence in the integrity of the company

Agree on principle, process and action on results by whole board
Assign committee to work out tool (e.g., prepare questionnaire)
Individual responses sent to e.g., personal assistant of chairman for analysis and consolidation
Consolidated results presented and discussed at next board meeting
Based on discussions of results, measures to improve performance are agreed on