

COVER STORY NOVEMBER 03

Board Evolution

Tomorrow's Boards

The changing face
of the future

the director

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Our governance landscape is changing. The contours are being altered by an array of natural and evolutionary changes including, of course, the regulatory reshaping that has followed the storm of outrage caused by director abuse and incompetence particularly in the United States. The new face of tomorrow's board is emerging. How different will it be?

Life in the boardroom is simply not the sinecure it used to be. There are increasingly punitive repercussions for individuals who don't measure up to the role and responsibilities of best practice corporate governance and who get caught for letting the side down.

But more importantly, the complexity and competitiveness of commercial enterprise demands that boards now play a full and constructive role in both the success and the survival of their organisations. Boards need effective executives, but equally, management needs the strategic, visionary and incorruptible input of competent boards. The question then is who will be best equipped to deliver this?

The board model dates back to the 1800s. And while it has its critics, no one has yet come up with a convincingly better structure for guiding enterprise. The problem is that boards frequently act as though they are still operating in the 1800s. Management has been forced to raise its game in the past 20-plus years. Now boards must ante up too. It is a meaner, leaner, more transparent and accountable world out there and so many elements of our daily existence are inter-related that organisations and boards can't act as they, or their

shareholders, might choose. Boards are ultimately accountable for any mess their organisations might make. The buck stops no longer with the CEO, but with the chairman and the board.

A growing demand for more professional performance and the changing demographics of our society are two of the more potent forces remodelling the face of tomorrow's board. It may seem to be slow to materialise, but the new face will take shape, and increasingly quickly. As Robert Skeffington wrote recently in the Australian *Business Review Weekly*, "A new breed of company director is emerging. He or she is younger, might never have worked as a chief executive, and possibly is from overseas or has worked overseas. The new breed will be paid more than existing directors – and will be under greater scrutiny from investors and the public."

ISSUES OF AGE

Attitudes and experiences canvassed in the New Zealand market reveal a future face not unlike that sketched by Skiffington. Recruiter and academic research shows that in New Zealand, as in Australia,

Asia and elsewhere, the ages of both executives and board members are dropping – though to be honest, they are dropping less and more slowly at board level.

The baby boom will, however, catch up with directors, sweeping an increasing number of the older generation, who now dominate the large table, from the room. This age attrition will be hastened by other factors more compelling than the simple reality of less wrinklies in the corporate world. And some researchers of the change process, like Massey University's Albany Campus academic professor Nick van der Walt, warn against any haste to appoint directors on the basis of age. "There are just as many older individuals up with the technology play and with a mind willing to embrace change. Look at the people," he warns, "not their age. It would be a very dangerous assumption to make that boards should be dominated by young people."

Some research of New Zealand corporate boards done by Korn Ferry International in 2000, and quoted by van der Walt and fellow academic Coral Ingley, found that the majority of New Zealand's male executive directors (in our largest companies) are aged between 51 and 55, and non-executive directors are mainly aged between 56 and 60. Women on our boards are, on the other hand, younger. The majority of women directors were aged 50 or younger and clustered in the 41 to 50 age group. More recent research conducted this year of the 300 largest companies in New Zealand and Australia, found the average age of directors is 58 with the average age of non-executive directors 60 and of executive directors 53.

Sheffield Search principal John Sinton sounds a similar note of caution on the age issue. He concedes that some boards are recruiting younger, choosing as he calls them, "emerging" directors. But he also points to a well-argued *Harvard Business Review* article published in September last year which concluded that having older members on the board might still deliver "an advantage". Deloitte chairman John Hagen simply doesn't see any evidence yet that boards are recruiting younger directors.

"Age is not the issue," says former New Zealand Institute of Management chairman and director of several, including public sector, boards, Doug Matheson. It is, he says, important to have some younger board members but boards need directors who satisfy the general requirements and attributes of a good director and who together bring the competencies, background and perspectives a board needs to be effective. "The perspectives and values

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of younger directors will be an important mix in future," he adds, "providing they satisfy the other requirements."

Nevertheless, it is likely that over the next five years New Zealand will experience a similar trend to that which has been predicted for Australia, if for no other reason than that our boards will increasingly be driven by global owners and Australian influences. And those predictions suggest that about a third of our directors will retire and they will be replaced by more of the new breed of director, including more women.

THE FEMALE INFLUENCE

Women represent only around 15 percent of directors of New Zealand's corporate boards, and the higher proportion of them are on public sector boards where legislative and statutory requirement ensure greater diversity of board membership. As van der Walt and Ingley point out, gender representation on our public sector boards is presently about 70 percent male and 30 percent female. In the private sector it is about 90:10.

The Government believes representation on boards should be more diverse. Rather than let natural selection deliver, it has taken an 'affirmative action' approach to appointments to the boards it controls through the Crown Company Monitoring and Advisory Unit (CCMAU), which recommends candidates for director appointments to crown company and state sector boards.

Former National prime minister Jenny Shipley lifted the issue of greater female representation on boards onto the political agenda. She undertook to raise the proportion of women on statutory boards to 50 percent by 2000. Legislation now compels organisations to make appointments with diversity in mind under the State Sector Act 1988 and the Employment Equity Act 1990.

Recruiters like Sinton again make the point that like age, gender is not the issue. The reality is, as he says, females increasingly inhabit senior executive corridors and that is one route to the boardroom door.

“Boards have their own unique requirements and criteria and they should be met regardless of gender. But as more females participate in senior levels of business the number of suitably qualified women will increase,” he adds.

John Hagen puts it slightly differently. He’s not in favour of discriminating board selection on any “politically correct” basis but agrees that women bring a “different perspective” to boardroom deliberations which can be positive. “It is the balance of skills that is important, not the gender,” he adds.

Apart from any question of how women might change the functioning of boards, they unquestionably change the face of the boards of tomorrow. They deliver both a different gender balance and lower the average age of board members. Those serving on boards now are serially younger than their male counterparts and that is unlikely to change over the next 10 years. Even as those on boards now age they are still, in percentage terms, a small fraction of the total number of directors. The greater number of women entering the boardroom will be younger than those traditionally appointed. Women are only now dominating top positions in the professional sectors and the organisational world and they get to the top relatively early as more of them opt for full-time professional careers and don’t take a break to have children.

Van der Walt isn’t sure that increased diversity of boards, gender or race based, makes any measurable difference and that the issue of diversity of board membership will happen as a consequence of supply and demand and a need to get the most competent people on board. Increasingly, the most competent and appropriate people will be women. And as New Zealand’s ethnic population diversifies so the spread of board representation will change.

CONCENTRATE ON COMPETENCE

But don’t force it, say some. Concentrate first on competency. And this is where van der Walt thinks the Government, through CCMAU, can play a positive role. Recruiters currently have a limited governance skills pool from which to draw candidates. If CCMAU and the Government focused on bleeding really skilled individuals – and not political favourites – by appointing them to public sector boards with high governance standards, this would in his opinion, serve to both increase the number and the competence of individuals available to take up directorships in the private sector as well.

At the moment it is difficult for white, male and facially creased boards to go far outside their network of contacts and feel comfortable that they are bringing ‘experience and competence’ to their deliberations.

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So do women make a difference to how boards work? What happens to board dynamics and process when one woman is added? And what happens when two or more women are added? Does it change things? Some academics, writers and observers think so. Some think affirmative action programmes and enforced board diversity, including adding more women, can have a negative impact on boards. Some behavioural extremists even suggest the presence of women in the boardroom threatens effective teamwork because they disrupt the male rituals – like talking about rugby and men things – which are a prerequisite to high performance boardroom deliberations.

As Sinton says in answer to the question of whether boards are likely to adopt stricter recruiting and assessment procedures in future: “The independence requirements [of new regulations] might enforce stricter recruitment requirements. But the desire for major shareholders and institutional investors to appoint people who best reflect their interests, without having regard for best practice recruitment processes, remains. And there appears to be some resistance to the notion of reviewing board performance.”

Matheson, on the other hand, is more sanguine. He sees selection on the basis of competence as the prerequisite but believes diversity (ethnic and gender) is essential to achieve a balance of backgrounds

and perspectives which also add to effective decision-making. “Diversity is important because without it the board does not have the perspectives, backgrounds and values that must [increasingly] be part of the mix at the board table. Ideally [the board] should reflect the mix of society, or the constituency the organisation serves, or is accountable to.”

On the question of a tougher approach to recruiting, he suggests that the “selection of directors be carried out with the same thoroughness and care as for the selection of a chief executive”. What is important to him is the “independence” of directors and so he doesn’t always see the move from the CEO’s corner office to the boardroom as either the most likely or the most desirable. “Many executives will make good directors, many will not.”

Matheson does not favour executive directors full stop. “Best practice governance is governance that functions in a way that is entirely independent of management or any employee in the organisation, or has any obligations to the organisation other than as a director on the board,” he says emphatically.

If Matheson’s interpretation of tomorrow’s board is a reflection of the way things are going, that too will change the face of corporate governance. Boards will be populated by a diverse group of individuals who bring very specific and complementary skills – engineers, academics, doctors, teachers, farmers, whatever – to the table and who are not necessarily clones of the traditional executive mould. “The skill sets of directors are different from the skill sets of CEOs. The responsibilities and accountabilities are very different. The personal attributes and competencies need to be different,” he adds. But he also thinks boards should allow and encourage their senior executives to sit on other boards to learn the ropes.

The composition of skills on boards is already changing. It might not yet seem like it, but the number of practising accountants and lawyers on boards is declining, in part because of conflicts of interest. That said, these two professional groups are still popular choices. While boards should have the relevant level of financial and legal competencies around the board table, if they need professional accounting or legal advice they should seek it from independent outside advice, adds Matheson. “Accountants and lawyers should be there [on the board] only because of their personal attributes and the director competencies they bring.”

REMUNERATION TRENDS

Tomorrow’s directors will also be better rewarded for their services, though they are far more likely to have to earn their fees and to be more rigorously measured


against performance. If boards are going to attract skilled, young, experienced and independent directors they will have to be better paid. While there does not seem to be any consensus about how many is too many boards for an individual to serve on, there is agreement that directors must put a lot more effort into the job. They are also increasingly liable. The natural extension of this is that they will serve on less boards and therefore need to earn more from each organisation and they will need to be compensated for risk.

John Hagen does not entirely agree with this view, saying that “it is difficult to get shareholders to see the importance of paying people” for their role as a director. John Sinton, on the other hand, says the trend (toward higher fees) is clear – and he cites Sky City and Telecom as examples. “It is clearly the result of greater demands on directors and higher expectations by shareholders,” he reasons.

Most directors currently earn in the \$30,000 to \$50,000 bracket. Five directorships, which is more than most commentators believe is desirable, means they might earn only \$150,000 to \$250,000 a year which, if they are committed independent directors, is not a particularly large compensation for what is becoming an increasingly demanding job.

“Good directors will be better paid in future if the board puts in place robust remuneration processes and methodologies that equate appropriate remuneration based on the role and responsibilities, the relevant comparisons, and the performance of the board member,” says Matheson. “You need to remember that a directorship is a short-term appointment. A board has to continually ensure it has the best composition and directors should not be on the board so long that they have a vested interest in the decisions the board has made in the past,” he adds.

Finally, our boards are likely to be populated by individuals with overseas experience. Directors with overseas experience will come from the increasing number of overseas-owned organisations, from the reality that an increasing number of talented individuals spend at least a portion of their career developing their skills offshore and, because boards will recruit with a global perspective in mind. As Doug Matheson puts it: “Directors with appropriate overseas experience or understanding will increasingly need to be included in the mix on the board.”

The change process is slow, but it is happening and the pace is quickening. Watch for the new face of the director of the future. 

By Reg Birchfield, editor