What makes a good director?

By Professor Nonna Martinov-Bennie and Dr Karina Luzia, Faculty of Business and Economics, Macquarie University

**Feature article Governance in practice**

- What combination of skills, experience and values are required of board members?
- Boards need to maintain a fine balance of desirable industry-specific skills, experience and corporate knowledge and must ensure not to be over-represented by individuals who are ‘insiders’.
- Boardroom diversity offers protection against potential bias in board decision-making.

A great deal is expected of boards of directors; expectations that can only be met by individual directors who have the requisite skills, experience, and who understand — and to some degree, reflect — the values and diversity of the communities in which their organisations operate.

With overall responsibility to set strategic targets, select key executives, and oversee management on an ongoing basis, the board’s primary focus should always be on long-term organisational success. Boards should not be involved in the running of day-to-day operations, but they must be highly productive as key organisational decision makers, displaying informed judgment and formulating long-term strategy in response to current and future forces affecting the organisation.

While board decisions are those of the board, and should not be directed or influenced by individual power or pressure, every individual board member must nonetheless be equipped to contribute. Individual directors need to be informed, innovative and skilled in relation to strategy and value creation. They also need to be experienced relationship-builders as all board relationships and interactions with management, employees, shareholders and other stakeholders are critical. A good director, therefore, is one that meets regulatory and legislative requirements, is independent, and who complements and most importantly, extends existing skills and experience on the board.

Each individual director has a vital role to play if the board is to be effective as an agent of the shareholders and other relevant stakeholders and create sustainable value for the organisation.

**Regulatory and legislative requirements**

The legal and regulatory requirements imposed on directors are complex and voluminous. New and potential directors must be willing to learn and to keep on learning. The ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations (Principles and Recommendations) Commentary to Recommendation 2.6 expressly states that listed entities should ensure formal educative induction programs and also ensure continuing professional development for their directors.

The legislative requirements as to what makes a good director are few, yet the duties are wide-ranging, and the obligations significant. Guidance provided through the Corporations Act 2001 is limited to the fact that a person appointed as director must be a natural person aged over 18 who has given consent to their appointment — and who is ‘not disqualified from managing a corporation’. There is no maximum age limit for directors. The implication of this is that as long as ‘disqualification from managing a corporation’ statutory
rules do not currently affect a person adversely, that person can be appointed as a director.

The circumstances under which a person may not be appointed a director (unless specific consent is obtained from relevant regulatory authorities) include where:

- A person is an undischarged bankrupt
- A person is subject to an unresolved personal insolvency agreement or an unresolved arrangement under Part X of the Bankruptcy Act 1966
- The concept of being ‘disqualified from managing a corporation’ includes having been convicted of offences involving dishonesty (where certain jail sentences were possible), certain offences under company law (such as a breach of duties as a director or insolvent trading).

It is also important to understand that under corporate law statute, and regulation generally, appointment as a director is not dependent on any particular qualification or skill of any kind. This means that as far as the regulatory process is concerned, anybody can be a director. However from a good corporate governance perspective, it is clearly unacceptable that just anybody should, in fact, become a director. It is also highly dangerous as the potential for personal and corporate liability is extremely high where boards act in an uninformed or negligent manner.

**Board composition and independence**

Whether the organisation is for profit or not-for-profit, private or public sector, listed or unlisted, independent critical thinking will be key to a board’s planning and executing organisational success. Accordingly, the composition of a boardroom must change regularly, in line with always-changing circumstances and current and emergent competitive forces. A ‘good balance’ is a board comprising individuals with up-to-date skills and knowledge whose group decisions are based on critical thinking, independence, industry experience and organisational knowledge to ensure organisations are in a position to create sustainable value for shareholders, clients, customers and other stakeholders. Boardroom diversity also offers protection against potential bias in board decision-making. It is a fine balance — while industry-specific skills, experience and corporate knowledge are crucial, sometimes boards are over-represented by individuals who are industry insiders; management of the corporation; self-interested large shareholders; or ‘mates’. Where boards lack balanced independence, biased decision-making with flawed judgment can result, and questions may be raised regarding whether the board is demonstrating leadership and value orientation.

The Principles and Recommendations provides comprehensive guidance on director independence. Although this guidance is directed at listed entities, it presents good practice for all organisations. Recommendation 2.3 outlines disclosure requirements and also provides examples of interests, positions, associations and relationships that might cause doubts about an individual director’s independence including whether he or she:

- Is, or has been, employed in an executive capacity by the entity or any of its child entities and there has not been a period of at least three years between ceasing such employment and serving on the board
- Is, or has within the last three years been, a partner, director or senior employee of a provider of material professional services to the entity or any of its child entities
- Is, or has been within the last three years in a material business relationship (for example, as a supplier or customer) with the entity or any of its child entities, or an officer of, or otherwise associated with, someone with such a relationship
- Is a substantial security holder of the entity or an officer of, or otherwise associated with, a substantial security holder of the entity
- Has a material contractual relationship with the entity or its child entities other than as a director
- Has close family ties with any person who falls within any of the categories described above;
has been a director of the entity for such a period that his or her independence may have been compromised.

In each of these cases, the interest, position, association or relationship needs to be assessed to determine whether it might interfere, or might reasonably be seen to interfere, with the director’s capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the organisation and its stakeholders generally.

Further, Recommendation 2.4 of Principles and Recommendations requires that with respect to listed entities, a majority of the board should be independent directors with the Commentary explaining that such a majority makes it harder for the board to ‘be biased towards the interests of management or any other person or group with whom a non-independent person may be associated.’

The Commentary to Recommendation 2.3 in Principles and Recommendations provides an apt summary:

A director ... should only be characterised and described as an independent director if he or she is free of any interest, position, association or relationship that might influence, or reasonably be perceived to influence, in a material respect, his or her capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally.

Existing and desirable board skills
An organisation should make known both the current skills matrix of the existing board along with its objectives in terms of its desired skills matrix. Beyond this, organisations should consider identifying a board’s relevant strengths and even weaknesses — although these should be in respect of the whole board and not in relation to an individual. The overall aim is to obtain information that provides a sound basis for shareholders’ decisions when voting for the best new director in elections. Shareholders and other stakeholders should be cognisant of current and desirable skills for the board, and attentive to addressing current skills gaps on the board in the election of directors. Any new director should contribute, in an appropriately balanced way, to reducing existing skills gaps and increasing diversity.

Board diversity
Board diversity is important to ensure it reflects the structure of society as multicultural, gender sensitive, comprising individuals from diverse personal backgrounds.3

The current lack of diversity in boardrooms across countries, industries and sectors4 has been acknowledged by many jurisdictions, including Australia:

In terms of governance, organisational leaders who are most successful in advancing diversity understand it both as a moral and business imperative: as something to be done because of their personal values and because their companies need it to be competitive.5

For example, in Australia, the Australian Institute of Company Directors’ (AICD) current gender target for the top 200 company boards on the Australian Stock Exchange (ASX200) is 30 per cent female representation by the end of 2018. To date, there is still some way to go with no female directors on 20 ASX200 companies, 29 companies needing two more female board members, and 99 companies needing one more female board member to reach the 30 per cent target.6

The Commentary to Recommendation 1.5 in Principles and Recommendations notes that increased gender diversity on boards is associated with better performance:

Gender diversity can broaden the pool for recruitment of high quality employees, enhance employee retention, foster a closer connection with and better understanding of customers, and improve corporate image and reputation.

A report by the Credit Suisse Research Institute7 supports this:

... in a like-for-like comparison, companies with at least one woman on the board would have outperformed stocks with no women on the board by 26 percent over the course of the last 6 years.

... the evidence suggests that a bit more balance on the board brings with it a bit less volatility and a bit more balance through the cycle.

The report also links diversity to a better mix of leadership skills particularly in the areas of mentorship and coaching — all characteristics that are important for leaders, including in the boardroom:

McKinsey and NASA have conducted various studies on leadership skills and have shown that women are particularly good at defining responsibilities clearly as well as being strong on mentoring and coaching employees. Hence, the idea that a degree of gender diversity at the board level would foster a better balance in leadership skills within the company may hold merit.

The increasing number of women graduates and women in business means that there is a far larger overall talent pool than in the past. Any company that chooses not to access this larger pool is thus bypassing valuable opportunities to potentially acquire much-needed skills and experience, and leaving talent to its competitors. This currently seems to be the case for the majority of Australian companies: according to the gender equity scorecard released by the Workplace Gender Equality Agency in November 2016,8 only 24.7 per cent of board directors are women.

With regard to competition, it is clear that a board that understands the market and the consumer and the real meaning of ‘customer value’ will be a superior board. In Australia, as is the case globally, women are more than 50 per cent of the population, and in many consumer areas, the primary decision makers. Consequently, women have an extremely important contribution to make in ensuring that organisational strategies are on target and remain that way over time. According to the Credit Suisse report, a good director will have the skill of understanding the market:

To the extent that women are responsible for household spending decisions, it makes sense that a corporate board with female representation may enhance the understanding of customer preferences. Not surprisingly,
consumer-facing industries already rank among those with the greater proportion of women on the board.9 Gender diversity is becoming more balanced, especially in those countries subject to mandatory requirements.10 For example, in Norway, the imposition of mandatory female board membership was at first the cause of furore. Proposed by a conservative male politician in 2003, and with the 40 per cent target becoming mandatory in 2008, it has now been accepted broadly resulting in a new focus on the real capabilities of directors — old and new. The history of women having no opportunity to be directors — or even senior managers — meant that there was a paucity of older women ready to be directors. As a consequence many of the new female directors were under 40 years of age — resulting in boardrooms with new energy and new ideas. The more diverse boards (in terms of gender AND age) were better equipped to understand key stakeholders — including customers and the strategic approaches required to reach and satisfy these customers. In short, gender diversity has been accepted in Norwegian boardrooms and also in France. The French 40 per cent target becomes mandatory this year but by the end of 2013 French corporations had already achieved approximately 25 per cent female board membership, compared to approximately seven per cent in 2007. However, while the overall focus of diversity initiatives in governance has been on gender, there is more to diversity and equity in leadership. According to Principles and Recommendations, diversity includes ‘...age, disability, ethnicity, marital or family status, religious or cultural background, sexual orientation and gender identity’.11 As Australia’s Race Discrimination Commissioner, Dr Tim Soutphommasane, states, attending to cultural and other forms of diversity on boards is ‘the smart thing to do’:12 There is a payoff for organisations that harness their ... diversity; it’s better for decision making in the long run. The richer the backgrounds represented ... on your board, the sounder your decision making will be.

Conclusion
Consideration of the issues outlined here is certainly fundamental to understanding what makes a good director in broad terms. However, every organisation is different and faces unique circumstances. The individuals who manage these organisations, and this includes the board as the senior managing body, must therefore also have a distinct understanding of the specifics of the organisation, its environment, and what will create and maintain its long-term success within that environment. Critically, they must also attend to the needs within the organisation, its shareholders and stakeholders — a broad and significant remit, as Gallagher and Martinov-Bennie emphasise:

Who should be a director? The person who can learn and apply new knowledge that relates to strategic planning, performance and reporting compliance. The person who can be a strong leader appropriately attending to the interests of shareholders and other stakeholders.13 This at its heart is the construction of value for all stakeholders: employing a vast array of capabilities that must be learned, nurtured, and put to work as and when needed. The very best directors will do all this, creating a board that provides space and opportunity for people who will continue to develop and improve its work. It is an individual director’s clear and constant focus on this objective that marks the genuine leader. 

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Notes
1 Corporations Act 2001, s. 201B
2 The Corporations Act provides for disqualification involving a notified disqualification (by the Courts or by ASIC) to a person; and certain criminal convictions or bankruptcy, with the latter effectively resulting in automatic disqualification.
10 See, for example, the discussion at www.womenonboards.org.au/pubs/articles/norway_bigpicture.htm
11 Principles and Recommendations, Item 3 of Box 1.5, ‘Suggestions for the content of a diversity policy’.