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BOARDROOM DYNAMICS

CERTIFIED SECRETARIES

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BOARDROOM DYNAMICS

UNIT DESCRIPTION

This paper is intended to equip the candidate with the knowledge, skills and attitudes that will enable him/her to positively and effectively influence and effect changes in the boardroom in the context of the existing dynamics of the Board.

LEARNING OUTCOMES

A candidate who passes this paper should be able to:

- Demonstrate an understanding of why focusing board dynamics is becoming increasingly important for organisations.
- Demonstrate an understanding of the importance of boardroom dynamics for organisations.
- Critically evaluate how boardroom dynamics might affect the quality relationships,decision-making, conversations, culture, diversity and other factors.
- Apply formal and informal methods to positively influence dynamics and enhanceboardroom performance

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COURSE OUTLINE

1. The emergence of boardroom dynamics in corporate governance

- 1.1 Defining boardroom dynamics
- 1.2 The evolving focus on corporate governance
- 1.3 The three phases of board evolution
  - 1.3.1 Ceremonial board
  - 1.3.2 Liberated board
  - 1.3.3 Progressive board
- 1.4 Building blocks of a progressive board
  - 1.4.1 Group dynamics
  - 1.4.2 Information Architecture
  - 1.4.3 Focus on substantive issues
- 1.5 Impact of boardroom dynamics on organisational performance
- 1.6 Interest in human factors (human resources, management of talent, organisational culture, politics etc.)
- 1.7 Shifts in approaches to leadership
- 1.8 Focus on ethics
- 1.9 A broader model for corporate governance
- 1.10 Organisational failures and impacts on boardroom dynamics
- 1.11 Role of the corporate secretary in Board room dynamics

2. Evolution of Codes of Corporate Governance

- 2.1 Evolution of codes - global trends
- 2.2 Incorporation of boardroom dynamics in codes of corporate governance
- 2.3 Impact of codes of governance on board culture, behaviors and effectiveness
- 2.4 Evaluating human capital
- 2.5 Self-regulation in corporate governance

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- 3.2 Board Structures: Unitary and two tier Boards
- 3.3 Components of governance structures
- 3.4 Board size
- 3.5 Committee structure
- 3.6 Director considerations
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- 3.8 Evaluating governance structures in organisations

4. Skills, Competencies and Diversity of the Board

- 4.1 Human capital aspects of the board
  - 4.1.1 Director competencies

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4.1.3 Evaluating individual board members
4.2 Personal characteristics of the board.
4.3 Defining and understanding the measuring of diversity
4.4 Types of diversity
4.5 Areas of diversity and their relationship to boards
4.6 Diversity thinking in a boardroom setting

5. Understanding Boardroom Dynamics
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5.1.1 The importance of board dynamics relative to board structure, demographics and attributes.
5.1.2 Psychological theories underpinning board dynamics
5.1.3 Characteristics of boards and board meetings
5.1.4 Board team processes
5.1.5 Board team outcomes
5.2 Individual and team resilience
5.3 Well- being and resilience of the board
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14. Power and Politics in Organisations

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15. Contemporary Issues and Case Studies in Boardroom Dynamics

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Introduction

The aim of this module is to provide the advanced knowledge, understanding and skills needed for the company secretary/governance professional to support boardroom performance by enabling both effective individual behaviors and group processes.

In recent years, high-profile corporate failures, maturing codes of governance, and an increasing interest in human capital intangibles have led to an increase in calls for governance professionals to focus on how the board works in practice as well as in theory.

Technical considerations are necessary but not sufficient to engender good governance. An appreciation of and competence in more behavioral, cultural and psychological aspects of boardroom practice is essential to being an effective modern company secretary/ governance professional.

This module explores boardroom practice in detail with a particular focus on understanding the dynamics of, and between, members of the board and how these factors contribute to an effective board and the sustainability of an organization.

The module also covers what boards and company secretaries/governance professionals can do differently and how they can influence and effect change within the remit of their role.

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Learning outcomes

After successful completion of this module you should be able to:

1. Demonstrate an understanding of the importance of boardroom dynamics for organizations.
2. Demonstrate an understanding of the different facets of boardroom dynamics.
3. Critically evaluate how boardroom dynamics might affect the quality of relationships, decision-making, conversations, culture, diversity and other factors.
4. Apply formal and informal methods to positively influence dynamics and enhance boardroom performance.

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CHAPTER ONE

DEFINING BOARDROOM DYNAMICS

People often use the term ‘board dynamics’ when they do not really know what is going on. However, here are some definitions of board dynamics that may help you initially orientate to what may be a new area and perspective of corporate governance.

Following the 11 Cs model (which will be discussed here in), board dynamics as a noun and as an area of study is:

1. The theory and application of the behavioral aspects of board functioning.

As an adjective describing the dynamics of boards, board dynamics are:

2. The psychological processes that influence how boards function.

If we combine these first two definitions, a slightly more technical definition is that board dynamics are:

3. The psychological processes that moderate structural and individual inputs to board functioning.

Furthermore, if we recognize that psychology is fundamentally about how people and groups relate to each other and that what happens in the boardroom can reverberate outside of it, then we reach this most complete definition of board dynamics as:

4. The interactions between board members individually and collectively, and how these influence, and are influenced by, their wider stakeholder system.

And finally, here are two additional, less technical definitions that add some explanatory colour following the themes that have been discussed in this chapter so far:

5. Board dynamics opens the black box of the boardroom behavior to see how things actually play out rather than what is supposed to happen on paper.
6. Board dynamics is about how boards behave, and indeed about how they misbehave, rather than about what tasks they do. It is about how they discuss issues rather than what issues they discuss.

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1.1 The Evolving Focus on Corporate Governance

The topic of **corporate governance** is a vast subject that enjoys a long and rich history. It's a topic that incorporates managerial accountability, board structure and shareholder rights. Theissue of governance began with the beginning of corporations, dating back to the East India Company, the Hudson's Bay Company, the Levant Company and other major chartered companies during the 16th and 17th centuries.

While the concept of corporate governance has existed for centuries, the name didn't come into vogue until the 1970s. It was a term that was only used in the United States. The balance ofpower and decision-making between board directors, executives and shareholders has been evolving for centuries. The issue has been a hot topic among academic experts, regulators, executives and investors.

Corporate Growth Places Emphasis on Developing Corporate Governance

After World War II, the United States experienced strong economic growth, which had a strong impact on the history of corporate governance. Corporations were thriving and growing rapidly.Managers primarily called the shots and board directors and shareholders were expected to follow. In most cases, they did. This was an interesting dichotomy, since managers highly influenced the selection of board directors. Unless it came to matters of dividends and stock prices, investors tended to steer clear from governance matters.

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In the 1970s, things began to change as the Securities and Exchange Commission (SEC) broughtthe issue of corporate governance to the forefront when they brought a stance on official corporate governance reforms. In 1976, the term "corporate governance" first appeared in theFederal Register, the official journal of the federal government.

In the 1960s, the Penn Central Railway had diversified by starting pipelines, hotels, industrial parks and commercial real estate. Penn Central filed for bankruptcy in 1970 and the board came under public fire. In 1974, the SEC brought proceedings against three outside directors formisrepresenting the company's financial condition and a wide range of misconduct by Penn Central executives.

Around the same time, the SEC caught on to widespread payments by corporations to foreign officials over falsifying corporate records. During this era, corporations started to form audit committees and appoint more outside directors. In 1976, the SEC prompted the New York StockExchange (NYSE) to require each listed corporation to have an audit committee composed of allindependent board directors, and they complied. Advocates pushed to get governance right by requiring audit committees, nomination committees, compensation committees and only one managerial appointee.

The 1980s Brought a Corporate Governance Reform Counter-Reaction

The 1980s brought an end to the 1970s movement for corporate governance reform due to a political shift to the right and a more conservative Congress. This era brought much oppositionto deregulation, which was another major change in the history of corporate governance.
Lawmakers put forth The Protection of Shareholders' Rights Act of 1980, but it was stalled inCongress.

Debates on corporate governance focused on a new project called the Principles of CorporateGovernance by the American Law Institute (ALI) in 1981. The NYSE had previously supported this project, but changed their stance after they reviewed the first draft. The Business
Roundtable also opposed ALI's attempts at reform. Advocates for corporations felt they were strong enough to oppose regulatory reform outright, without the restrictive ALI-led reforms. Businesses had concerns about some of the issues in Tentative Draft No. 1 of the Principles of Corporative Governance. The draft recommended that boards appoint a majority of independent directors and establish audit and nominating committees. Corporate advocates were concerned that if companies implemented these measures, it would increase liability risksfor board directors.

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Law and economic scholars also heavily criticized the initial ALI proposals. They expressed concerns that the proposals didn't account for the pressures of the market forces and didn'tconsider empirical evidence. In addition, they didn't believe that fomenting litigation wouldserve a purpose in improving board director decision-making.

In the end, the final version of ALI's Principles of Corporate Governance was so watered down that it had little impact by the time it was approved and published in 1994. Scholars maintainedthat market mechanisms would keep managers and shareholders aligned.

The "Deal Decade" Leads to Shareholder Activism

The 1980s was also referred to as the "Deal Decade." Institutional shareholders grabbed moreshares, which gave them more control. They stopped selling out when times got tough.
Executives went on the defensive and struck deals to prevent hostile takeovers.

State legislators countered takeovers with anti-takeover statutes at the state level. That, combined with an increased debt market and an economic downturn, discouraged merger activity. The Institutional Shareholder Services (ISS) was formed to help with voting rights. Shareholders struck back with legal defenses, but judges often favored corporate decisions when outside directors supported board decisions. Investors started to advocate for more independent directors and to base executive pay on performance, rather than corporate size.

Financial Crisis of 2008

By 2007, banks had been taking excessive risks and there was growing concern about a possiblecollapse of the world financial system. Governments sought to prevent fallout by offering massive bailouts and other financial measures. The collapse of the Lehman Brothers bank developed into a major international banking crisis, which became the worst financial crisis since the Great Depression in the 1930s. Congress passed the Dodd-Frank Wall Street Reformand Consumer Act in 2010 to promote financial stability in the United States.

The fallout from the financial crisis has placed a heavier focus on best practices for corporategovernance principles. Boards of directors feel more pressure than ever before to be transparent and accountable. Strong governance principles encourage corporations to have amajority of independent directors and to encourage well-composed, diverse boards.

Advancements in technology have improved efficiency in governance and they've created newrisks as well. Data breaches are a new and real concern for corporations. The first targets werebanks and financial institutions. As these institutions have bolstered their security measures, hackers have turned their efforts to smaller corporations within a variety of industries, including governments.

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Today's boards of corporations and organizations of all sizes are finding that the best way for them to protect themselves, their shareholders and stakeholders is to use technology to their advantage by taking a total enterprise governance management approach. Diligent, a leader inboard management software, provides for their needs with Governance Cloud, a suite of fully integrated and highly secure governance tools. Diligent's software solutions help boards put their best foot forth in assuring transparency, accountability, compliance and efficiency.

The history of corporate governance continues to be rewritten. How we define corporate governance will continue to be in a state of evolution in the coming years. Diligent will be following the trends and regulations to help boards perform their best regardless of what thefuture brings.

1.2 The three phases of board evolution

1. Ceremonial board
2. Liberated board
3. Progressive board

Introduction

Boards of directors have undergone a rapid transformation since the Sarbanes-Oxley Act of 2002. The shift in power between the CEO and the board is perceptible.

Directors are taking their responsibilities seriously, speaking up, and taking action. It's a positive trend and an exciting time for boards. But the evolving relationship between the CEO and the board has yetto find the right equilibrium in most cases. It's important that boards become active, but thereis danger in letting the pendulum swing too far. Astute directors and CEOs sense the tension.

They recognize that just as past practices have failed them, recent attempts to make the boarda true competitive advantage are not always hitting the mark.

The Real Risk of Value Destruction

The change in boardrooms today is not marked by the people but rather by the social atmosphere. Boardrooms have more energy, liveliness, inquisitive interactions among directors, and thoughtful engagement by CEOs. The difference today is a mindset, an emergingcollective desire to do something meaningful. It appears that boards of directors, as an institution, are coming of age.

Much of the public outcry—and resulting regulation—of recent years is based on the failure ofboards to root out fraud, some of which destroyed whole companies. But boards are recognizing that they have failed in another, arguably more widespread, way: by allowing (sometimes inadvertently contributing to) faltering performance.

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Entire industries collapsed in the wake of the dotcom bust; too many companies failed to adapttheir businesses to the different external environment after the recession began and after the 9/11 tragedy. No one could have foreseen global terrorism, but what about anticipating the fallout from the go-go years of the New Economy, or not recognizing the importance of emerging new channels? **Couldn't boards have prompted their managements to pinpoint and consider these issues? In some cases, boards have made costly mistakes. How about hiring a CEO from the outside who is a master of cost-cutting— when the company needed a leader who could grow the business? Or tying the CEO's incentives to the wrong goals? Or approvinga grand growth strategy with an unhealthy appetite for risk?** Most boards want to do the rightthing, whether it's complying with the new rules (and there are a lot of them) or contributing in substantive ways on matters of choosing the CEO, compensating top management, ensuring that the company has the right strategy, and providing continuity of leadership and proper oversight. Their commitment and level of engagement marks a new stage in their evolution.

The good news is that these boards are unlikely to commit the sins of omission that were common among the passive, CEO dominated boards just a few years ago. The bad news is thatthey are now vulnerable to committing sins of commission. That's because past board experience has not fully prepared directors and CEOs for the challenges they face

today.
Without clear guidelines to take them forward, well-meaning boards can actually erode thevitality of the company and drain time and energy from the CEO. It's a real danger, and companies truly suffer when this happens. **To achieve their full potential, boards must continue to evolve**. They must make a conscious effort to go to the next level.

The Evolution of the Board

Boards began their evolution in the pre–Sarbanes-Oxley era of passivity. Back then, they were"Ceremonial" boards, because they existed only to perform their duties perfunctorily.
Sarbanes-Oxley has driven many boards to a second evolutionary phase; directors have becomeactive and "Liberated" themselves from CEOs who previously dominated the boardroom. But there is also a third phase awaiting boards, when active directors finally gel as a team and
become "Progressive."

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1. **Ceremonial Boards**

A decade ago, when one non-executive director joined the board of a paragon of American industry, a long-serving colleague told him, in private, "New directors shouldn't speak up duringboard meetings for the first year." That attitude is untenable today and, in fact, that board is much different now. But such comments are indicative of the **culture of passivity that permeated the Dark Ages of corporate governance.**

Some readers may remember when such Ceremonial boards were commonplace. **Managementhad all its ducks in a row by the time a board meeting began. There was a scripted morning presentation that was rehearsed to the second in a tight agenda. The CEO communicated very little with the board between meetings, other than with the one or two confidants the CEO trusted and worked with if the need arose.**

These boards perfunctorily performed a compliance role. Many directors served for the prestige and rarely spoke among themselves without the CEO present. They made sure to fulfill their explicit obligations, including attending the required board meetings and rubber-stamping resolutions proposed by management.

The general interest media rarely reported directors' names. So back then, the prospect of shame and embarrassment when a company ran into trouble wasn't much of a threat." Such were the norms and expectations of directorship during this era. Most readers will recall a few boards that fit this description at some point in time. Hopefully, it doesn't sound like any boardson which they now serve, though these boards do still exist.

2. The Liberated Board

Most boards left their Ceremonial status behind after the passage of Sarbanes-Oxley. A newgeneration of CEOs now expects boards to contribute. And candidates for directorship now expect active participation as a condition of their acceptance. There is a general sense of excitement as directors embrace an active mindset.

The transition to liberation had really begun about a decade earlier. In 1994, the GeneralMotors board, advised by Ira Millstein, first published its "Guidelines for Corporate
Governance." The document was widely praised as a model for corporate boards. BusinessWeek even called it a "corporate Magna Carta," referring to the document signed in 1215 by King John that stipulated, among other things, that no one, including the King, is abovethe law

The comparison was fitting; GM's CEO and Chair, Robert Stempel, stepped down late in 1992 after losing the confidence of GM's non-executive directors. When the non-executive directorsnamed one of their own as Chair, it signaled a distinct change in the general attitude of boardsas passive bodies. No one dreamed such a thing would happen at the world's largest company.Many directors around the country took note. In particular, the boards of several prominent bellwether companies, including those at American Express, AT&T and IBM, followed GM's lead.

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Still, not that many boards entered the ranks of the Liberated in the 1990s. Though board watchers and activists such as Bob Monks, Nell Minow, Sarah Teslik, Richard Koppes (of Calpers), and others pressed for reform, many companies under fire were reluctant to makewholesale changes in their governance practices.

There was no urgency for change until the scandals broke at Enron, WorldCom, Tyco, HealthSouth, Adelphia, and elsewhere. Then came the rapidly passed Sarbanes-Oxley Act of 2002, with its broad provisions on Audit Committee work, internal controls, and fraud prevention, along with the ensuing reforms enacted by the Securities and Exchange Commission and the stock exchanges, lawsuits filed against directors and corporate officers, and the public embarrassment of some very experienced directors. With so much shareholder and bondholder value evaporated in the scandals, the capital markets also began paying closerattention to corporate governance and to the possibility of pricing the perceived quality of transparency and governance into securities.

Directors saw their peers chastised and overwhelmingly heard investors' calls to become active.Although some boards remain Ceremonial today, the pendulum swung decidedly toward Liberated boards. In many cases, incoming CEOs helped drive the change.