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Corporate governance - no mystery, but no panacea either

by Carolyn Evans and Tanya van der Wall

As much as a well-functioning board or senior executive team are much more than just the sum of their parts, so too is good corporate governance. It relies on elements such as policies and procedures being well-designed and in place, but there is much more to it than that. Corporate governance is a process - ongoing, carried out by people throughout the organisation - so the sum of its parts will not coalesce without intent, a mutual will to make the organisation capable of achieving the desired results in the right way. That intent is then the guiding light for:

- right decisions, well made, and implemented appropriately;
- that come to fruition and see the organisation's purpose realised, to the benefit of those it is there to serve;
- doing this not just today and tomorrow, but sustainably, so that next week and next year the enterprise can keep the promises it makes, which are bound up in its relationships with employees, volunteers, customers, clients, suppliers, and so on.

What to look for in those qualitative features can seem a mystery, but that is not the case any more than corporate governance is a panacea for all the ills of an ailing enterprise.

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Fundamentals - in for-profit & not-for-profit entities alike:

'Owners'

This is the group that has the right to decide the entity's form and purpose, and the board is accountable to them for its decisions and outcomes.

It hardly matters who this is: a public official, a private group (family, investors, trustees, membership group) or a public group (shareholders in a listed firm). The nature of ownership may change the fine details of accountability, but not the fact that explanations are owed as a routine and regular thing, seen in an account rendered in line with the purpose and objectives of the organisation as defined by the owners.

Chair

However the person is chosen, or whatever title the role may have, the purpose of this role is to 'facilitate the effective contribution of all directors and promote constructive and respectful relations between directors and between board and management'.[7]

Board - the role of a board can be put pithily as oversight, insight and foresight.[8]

Directors

There is no chance of good governance without a well-functioning board: members need to be chosen for relevant competencies, capacity to work collaboratively, ability and willingness to formulate and express an informed viewpoint, and, critically, time to properly carry out their role.

Deserving the trust

Ultimately, every organisation, whatever the ownership or structure, has a purpose and resources to achieve it. One way or another, those resources are given in trust to be directed to the purpose of the organisation. Thus, at its simplest, good governance is about conduct and behaviour that shows the organisation continues to deserve that trust, expressed in the relationships an enterprise has with employees, volunteers, customers, clients, suppliers - even the community and society as a whole.

Like making a great cup of coffee, of course something always remains in the eye of the beholder (or at least, their tastebuds), meaning that to achieve good corporate governance also needs the same crucial ingredient - the care factor. No matter how good the coffee machine, a don't care attitude from the barista will get you coffee you probably don't want to drink; an insincere, instrumental, or offhand, 'tick the box' attitude to corporate governance will most likely create masses of activity and screeds of paperwork, but not render anything that adds value for stakeholders or aids the enterprise in deserving trust, based on keeping promises made or implied in its work.

Part of the problem is that corporate governance has been a topic de jour routinely over a couple of decades, and some always attempt to shroud it in professional mystery and complicated processes (perhaps to generate the latest growth industry for opinionated commentators!).

But from where we sit, the importance of intent is crystal clear in the fallout from spectacular examples of poor governance: Australian readers will not soon forget headline cases such as the collapse of HIH and the varied fortunes of James Hardie, where the intent was shown to be otherwise.

Sadly, rather more common than headline cases are numerous reputations tarnished or destroyed by eventual discovery of inappropriate workplace behaviour, shady business practice, falsified qualifications and so on - when corporate governance failed to keep such behaviours in check, discovering and remediating them sooner rather than later. Equally regrettable, if also rather less spectacular, are legions of small organisations (including many nonprofits) that are forced to close their doors, often in circumstances that were highly avoidable if board and management had better understood the specific roles that they each play in continuing to deserve the trust of stakeholders.

What is it?

Put simply by the Australian National Audit Office in 1999, corporate governance:

> *... generally refers to the processes by which organisations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised by the organisation.*[1]

A considerable volume of material has since been written on what good corporate governance is or should be, who has it and who doesn't, what it needs, how to get it and who should take the lead on putting it in place.

But, after very wide reading on such matters, for a starting place it is very hard to go past the scene-setting by Justice Owen in his judgement on HIH:

> *The key to good governance lies in the substance not the form. It is about the way directors of an organisation create and develop a model to fit the circumstances of that company and then test it periodically for its practical effectiveness. It is about the directors taking control of a regime they have established and for which they are responsible.*[2]

Elsewhere, the United Nations and the ASX Corporate Governance Council are useful sources that publish whole volumes to provide guidance to their members, members that operate in a great diversity of contexts.

It is also well worth noting that many global organisations, such as the UN, take a strong line in asserting that the call for good corporate governance is universally applicable to all organisations everywhere, regardless of their prevailing legal regime or the organisation's ownership or structure, and our experience is strongly in accord with this line.

Thus, even if the detail of implementation is highly contextual, it matters little to the fundamentals of good governance whether the broad purpose of the organisation is presumed from ownership (eg. to generate returns for shareholders in a commercial company), or implied from its nature (eg. a not-for-profit which must also be not-for-loss while delivering on its existential purpose, or raison d'être). For an example of a definition, the overarching UN view of good governance is that:

> *Good governance has 8 major characteristics. It is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It assures that corruption is minimized, the views of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making. It is also responsive to the present and future needs of society.*[3]

How much is enough?

Owners, board and management certainly have their own distinctive role in good corporate governance, each of which is equally necessary, but, at any link in the longer corporate governance chain, how much is enough is harder to answer. More is definitely not always more - using a corporate governance house brick to swat a governance fly won't save the organisation if it becomes unable to deliver on the fundamental purpose of the organisation. And just putting one of every type of expert on the board does not achieve good governance - it might even be quite counter-productive if they start intruding unduly on the rightful work of management and staff.

No wonder the ASX Corporate Governance Council has also acknowledged that "there is no typical organisation and no single readily identifiable model for corporate governance".[5]

Wise words indeed, redolent of the point made by Justice Owen - boards and management teams can't cut and paste a regime of good governance, they must put one together that suits their organisation and their circumstances.

Fundamentals continued:

Who does what?

One of the chestnut arguments in both for profit and nonprofit enterprise is the division of roles between the board and the senior team, including the allocation of governance tasks between board committees and related staff work.

Getting it right is one of the art forms of good governance - whether you are looking from the vantage point of the board or management.

For example, nothing will demoralise management as much or as quickly as undue meddling by the board.

Equally, strategic decision making by the board is not only their right but their obligation, with a concomitant need for sufficient and timely information on which to base their work.

Perhaps the only thing worse than getting the balance wrong is rolling both jobs into one- because realistically, it almost never ends well when any group, sets out to - in effect - supervise themselves![9]

Of course, a close second is trying to create a great board by just appointing a flock of highly competent executives or specialised professionals and calling them directors. The role of director is not some sort of super-management function - director's responsibilities and accountabilities are distinctive and require a different view and approach to carrying them out well.

Noting that measures to achieve good governance are effectively a risk management strategy, the extent and complexity of the regime naturally depends on the extent and complexity of the organisation, since that is a prime determinant of the risk profile of the organisation.

Of course, it is also a truism of risk management that the administrative overhead of overdoing it is nearly as deleterious as the more obvious downside of not having enough.

Sheer practicality: If not, why not?

The ASX Corporate Governance Council goes on to say that "[d]isclosure of a company's corporate governance practice, rather than conformity with a particular model, is central" to their approach.[6]

Labelling this the "if not, why not" approach, they note that there are many sound reasons why aspects or elements of their corporate governance guidelines may apply only in part, or not at all, to relevant organisations. The point is to make that assessment, record it, and duly report to owners or their equivalent in that enterprise model (for example, the membership of an association) and to other stakeholders.

In our experience, this "declare it and explain it" approach works very well due to its sheer practicality. It does so regardless of the nature of the organisation, not least because of its strength from overt transparency and consequently clear accountability for decisions.

For organisations not obliged to follow the ASX guidelines - or any other such regime that a competent source recommends - one approach is to dismiss them as irrelevant (to not-for-profits and other privately owned companies, membership organisations, etc.). As a reality check, though, it is worth thinking about stakeholder expectations, taking perspectives across a broadly-defined idea of stakeholders (employees, volunteers, customers, clients, suppliers - even the community and society as a whole). For the most part, these are shaped by the news headlines, but that also provides a lesson from the experience of others: better to report proactively than to have a reporting requirement designed by another thrust upon the board, forcing the board to explain reactively when stakeholders raise questions.

Put another way: even if it's not a legal requirement, better to stay abreast of a well thought through and well structured reporting approach, as one productive avenue for demonstrating good governance and maintaining the trust and confidence of stakeholders, rather than lose that trust and then be faced with the labours of Hercules to regain it.

Further reading:

The references footnoted in this paper are also great general reading for boards and senior teams.

1. Australian National Audit Office Corporate Governance in Commonwealth Authorities and Companies (1999), 1.
2. Owen, N The Failure of HIH Insurance Volume 1: A Corporate Collapse and Its Lessons (2003) xxxiii. Also Justice Neville Owen 'Corporate Governance — Level upon Layer' (Speech to the 13th Commonwealth Law Conference, Melbourne 13-17 April 2003), 2.
3. UN publications on this topic are numerous. This particular quote is online at: www.unescap.org/pdd/prs/ProjectActivities/Ongoing/gg/governance.asp
4. Jansen, P J and A R Kilpatrick 'The Dynamic Nonprofit Board' (2004) 2 The McKinsey Quarterly 23.
5. ASX Corporate Governance Council Corporate Governance Principles and Recommendations with 2010 Amendments (2nd Ed, 2007; re-issued in 2010), 6.
6. Ibid.
7. ASX Corporate Governance Council (2007/2010), 17.
8. For example, see Julie Garland McLellan: www.mclellan.com.au/release2.html
9. Two tier board structures, such as in Germany, still differentiate clearly between managing and overseeing - for a useful discussion: Shi, E 'Board Structure and Board Composition in Australia and Germany: A Comparison in the Context of Corporate Governance' (2007) 4 *Macquarie Journal of Business Law* 197.