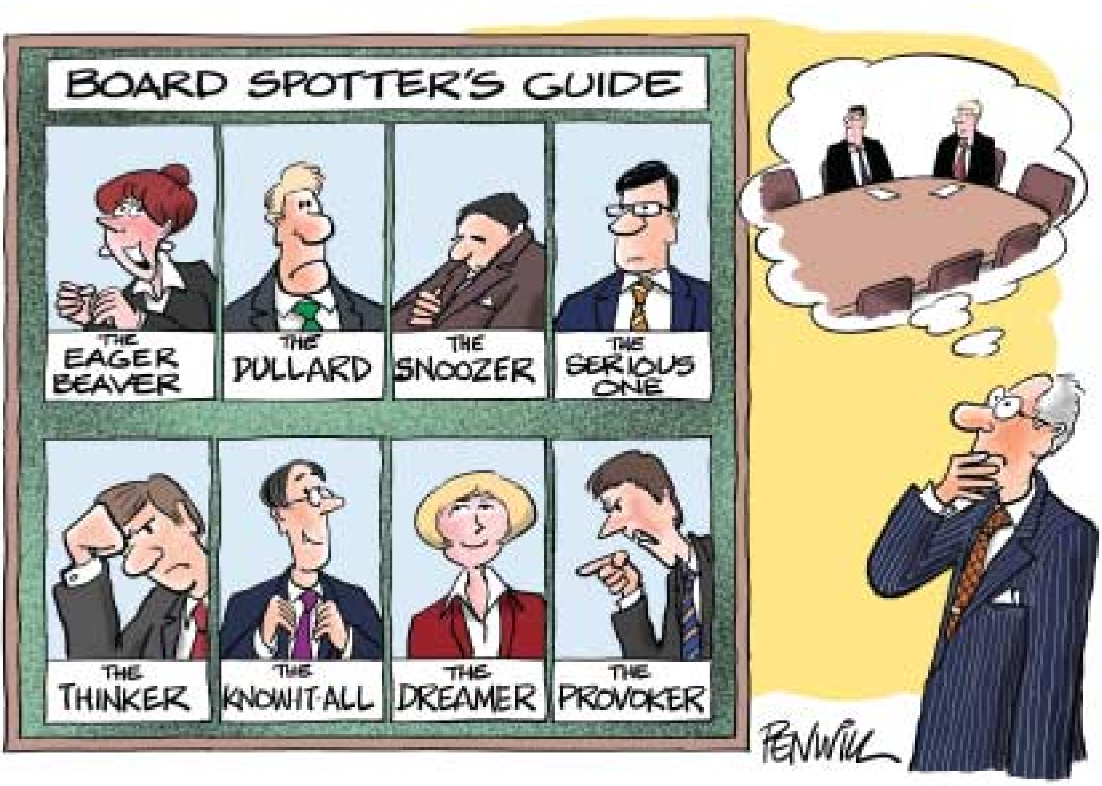
Uncertainty, Human Nature and Board Effectiveness Reviews



INDEPENDENT AUDIT LIMITED

FOREWORD

"When people are on their best behaviour, they're not necessarily at their best"

Alan Bennett's quote from *Dinner at Noon* serves as a typically pithy observation on the human condition.

Although Bennett was describing the etiquette of guests at the Crown Hotel, Harrogate the tension between prescription and personality applies equally to a board's effectiveness.

The UK has carved out a unique approach to governance by eschewing a wholly rules-based code in favour of the principle of comply or explain combined with guidance, not precisely defined standards. For most boards, most of the time, this works well but it isn't always easy. Securing the many advantages needs careful management.

As I know from personal experience, the absence of definitive rules can exacerbate divisions within boards – especially those containing directors whose formative periods have been spent in cultures which depend heavily on the enforcement of rules to moderate behaviour. But whatever and wherever the board, human nature will dominate. That too is a good thing: individualism and character bring questioning, insight and ideas. But with unrelenting uncertainty as a backdrop, moulding the right shape and bringing out the best is much more of an art than many imagine.

At Independent Audit, we have learned that successful business leadership depends on the management of a complex dynamic which enables effective strategic decision-making while dealing with uncertainty and maintaining a perspective beyond the boardroom. Achieving this requires a solid foundation of trust within the board, and an effective board effectiveness review can reinforce that foundation.

To be effective the review must first and foremost be an honest one in which participants feel able to express their inner feelings about performance – their colleagues' and their own. And secondly, it must be contextual – performance is always a relative measure.

But perhaps the most important aspect of an effective board appraisal is that it doesn't focus on conformance to norms, but rather on behavioural outcomes. Unlike the snobs in Bennett's TV programme, what directors actually do is what matters and their score against an etiquette tick box is secondary.

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THE STARTING POINT

We've finally got used to board effectiveness reviews. The traumas of 2008 (and a bit of help from regulators) convinced most listed company boards, and many others, of their usefulness. Reviews are now a standard part of the corporate calendar, with rather more emphasis on self-improvement than on self-congratulation.

That's all to the good. But 'standard practice' presents perils of its own. Novelty turns into routine, and routine tends to conventional thinking. It's only human.

And human nature should be the starting point for reviewing the effectiveness of any institution. Boards are prone to all the failings flesh is heir to. One of these is a tendency to rely on rules and systems, to see them as our hedge against uncertainty. And there's a danger that we look at boards as bodies that can be led to a state of effectiveness by making sure the processes and structures are sound. But life isn't like that.

Rejecting the false comfort of rules and systems doesn't mean dumping rules and systems, simply adjusting them, and our attitudes, to take account of three realities:

- Boards, like any other institution, have to cope with constant uncertainty. A business can no more escape this clinging reality than any one of us can do without breathing. Accepting this truth is a 'light bulb moment'. We become more alert to risk, more practical in devising ways to define and allow for it.

- People – directors themselves as well as managers and stakeholders – are a further major source of uncertainty. Board effectiveness hinges on how they act, talk, report and challenge, all of which are dependent on circumstances and relationships, as well as individuals who themselves might behave differently from day to day.

- Boards are not operating in a bubble. Outside and inside, things are constantly changing. Stability can be knocked quickly by events, sometimes unforeseeable, at other times missed through complacency, myopia or distraction.

These realities unavoidably and relentlessly act as constraints on a board's effectiveness but are often underestimated or unrecognised, leading to misplaced expectations of what a board can achieve and how effective it can truly be.

In their early days, board reviews tended to revolve around process-focused assessments of readily-identifiable characteristics. As they mature from the initial adoption phase, they need to move on. But to what? There is no authoritative definition of what a board effectiveness review should look like. What follows is Independent Audit's view, based on our experience of working with a large number of listed companies' and other organisations' boards. It isn't trying to be a complete framework – we're simply trying to provoke thought while keeping to a digestible length.

This view of how board effectiveness assessment should evolve means a combination of…

… **focusing on the fundamentals** of what a board needs to be effective at doing, in an environment driven by uncertainty, people's behaviour and change

… **getting the enablers right** so that the practical things such as composition, organisation and process set the board up for success

… **going broader and deeper** into the governance structures on which the board depends, and

… **looking to the future** to make sure the board will be effective for tomorrow's organisation as well as today's.

Throughout what follows we suggest that boards start from where they actually are, treating circumstance and human nature as fundamental and constant factors instead of irritating bits of grit in the machine which can be eliminated through better process.

We believe that this is key to a better understanding of board effectiveness, one which encourages board level rules and processes to be developed in ways that recognise the constraints and complexities brought by the realities that boards face.

Note: For the purposes of this paper, we treat the board and its committees as a composite whole, not distinguishing between the different elements of the board governance structure.

THE FUNDAMENTALS

When you start to think about board effectiveness, the first question is "effective at what?" And that's where you instantly run into trouble, since the answer can vary not only from board to board but from day to day, as the demands of the business change. There are of course lists of statutory and other duties that a board has to fulfil, but usually the company secretary can be relied upon to keep these on the agenda, and anyway just putting a tick into these boxes isn't what makes a board effective.

One response to this dilemma is to reframe the question as "is the board constituted and organised to be effective?" which shifts the emphasis to composition and process. But although these are important, we don't think it's the best place to start. Instead, we think that a good review will help to show whether, and how, the board is meeting four fundamental and interwoven objectives.

Boards have to deal with uncertainty all the time. Directors know this only too well but it's easy for others – analysts and regulators especially – to forget it. The task is to deal with it well, factoring it in as sensibly as possible but not allowing it to hamper decision-making.

Then there's a limit to what boards can – and should – actually do. They have to place their trust in management, both the people and the processes. They have to rely on management getting things right and keeping things under control. But rather than taking this for granted, an effective board will be looking to understand its basis for trust – what makes that trust well-grounded, and what's needed to maintain and improve its grounding.

Secure these two objectives in the top half of the box and the board will maximise its chances of making the right strategic decisions. Even the best boards will sometimes make errors of judgement – that goes with being human – but working effectively and actively looking to learn should reduce both the likelihood and the impact of getting it wrong.

And a truly strategic view of the board's effectiveness will also take account of relations with actors who don't sit in on board meetings: employees, shareholders, analysts, the media, politicians and customers. Any one of these groups can help decide the organisation's fate. A good board will constantly seek to look outside the boardroom, trying to spot and, ideally, anticipate what will impact them from where.

The list on the next page summarises the core elements of each objective. The components of effective governance will vary according to the purpose of a particular organisation, and any individual board will be able to propose its own amendments and additions to our list. But we think it's enough to get you thinking about the essentials that have to work consistently well for a board to do its job.

You'll see that this list goes beyond the quality and capability of the directors, and means looking at how the board connects with the company as well as at what goes on in the boardroom. Most importantly, a truly effective board is inseparably connected with effective management who understand the value of enabling the board to do its work well.

Fundamentals of Board Effectiveness

Some questions for board reviewers…

Dealing with uncertainty

- Taking a broad view of what constitutes risk
- Approaching risk acceptance rigorously
- Balancing risk and reward
- Understanding resilience
- Planning contingencies
- Assessing possible scenarios
- Spotting threats to reputation
- Devising a confident external message

How does the board provide leadership in the face of uncertainty?

Achieving and maintaining grounded trust

- A thirst for significant information and considered opinions
- Clear procedures for verification
- An atmosphere of challenge and debate
- Mutual respect

What does trust look like? Are answers sought and given? Is there rigour and respect?

…a basis for trust in key people

- Attitudes
- Competence
- Depth
- Ethics

How does the board assess the people it depends on? How does it deal with what it finds?

…a basis for trust in internal processes

- Accountability, reporting and escalation
- Risk assessment
- Control, assurance and compliance
- Crisis response

Are internal processes transparent? How does the board know they are working?

Making the right strategic decisions

- Having a shared sense of direction
- Setting the big decisions in their context
- Retrospectives: how decisions turned out and why
- Real debate
- Mix and fit of board members
- Executive succession

How can the board make well-judged decisions? How well does it learn from experience?

Looking beyond the boardroom

- Understanding what external audiences think
- Explaining and persuading
- Distinguishing short- and long-term goals
- Listening to the organisation

How does the board deal with employees and the outside world in the face of uncertainty?

Dealing with Uncertainty

A recognition that we can't know all we'd like to know provides the firmest basis for confidence building measures; it lends drive and focus to efforts to acquire and understand reliable information. Providing leadership in the face of uncertainty requires a combination of the following elements.

Taking a broad view of what constitutes risk

A focus on 'key strategic risks' is all very well, but does it take change and emerging issues into account soon enough? Does it include those vital 'business as usual' processes? What about (for instance) reputational exposures? And do directors share a consistent view of the company's risk profile?

Approaching risk acceptance rigorously

Boards need to be able to explain what constitutes acceptable risk. Only then can they communicate coherently to the rest of the organisation, or even be sure they ask the right questions when proposals are placed before them. Has there been a rigorous risk analysis? How far have projections factored in the cost of mitigation? What about less tangible risks such as not having the right skills and capabilities? Or the risks arising from people's fears and ambitions?

Balancing risk and reward

There's always a cost of some sort – certainly financial, possibly strategic. Does the risk profile consider the price of moving to where you want to go? Are you ready to pay? And is it clear who's bearing the risk and who would gain the rewards?

Understanding resilience

Does the board have a plausible picture of what happens when things go wrong? Does it understand the assumptions used in modelling that picture? Can the business afford it if things don't turn out as planned? What sort of event, financial, operational or reputational, would put the organisation under sustainable stress?

Planning for contingencies

How far has the board thought through responses to potential crises? When would it intervene if a negative trend just carried on? Are there criteria for deciding whether to halt a major project? And are there actually opportunities for the board to consider this sort of action before a crisis develops?

Assessing plausible scenarios

Boards are often uncomfortable with scenario planning – it can seem a poor use of precious time to ponder the unknown. But asking 'what if?' helps expose challenges and threats. And greater familiarity with possibilities makes you less likely to be thrown off balance should they crystallise.

Spotting threats to reputation

Value is often destroyed by hits to reputation and such damage can be the hardest to repair. Yet surprisingly little board time is commonly spent considering how this type of threat can arise, either from big decisions (such as projects, takeovers and product launches), or from corporate and individual behaviour. The consequences of ethical failures are often downplayed or even ignored.

Devising a confident external message

Investors need to take uncertainties into account, and a clear explanation of risks can help manage their expectations. Investor relations can be improved if briefings convincingly demonstrate well-grounded confidence in risk assessments and mitigation strategies. And management and board forming a view on how quickly or slowly a risk is likely to crystallise, and how far stakeholders might ultimately care, will help shape the message and communication strategy.

Achieving and Maintaining Grounded Trust

Coping with uncertainty requires trust in both key people and processes. And a board cannot – must not – get immersed in detail in the absence of a crisis. Directors must therefore understand what degree of trust can be placed in the people and processes they rely on. Not just superficial trust that takes things for granted, but grounded trust which is based on a demonstrably solid foundation.

Attaining this requires organisation – to give the demonstrable basis for trust – as well as carefully cultivated attitudes. The all-too common alternatives are over-ready acquiescence and, at the other extreme, low-intensity corporate warfare, an outcome which incentivises self-protection instead of service.

The basis for trust must be kept up to date as people, circumstances and pressures change. And that basis needs to be evidenced – it isn't enough just to rely on past experience. This is particularly important in financial services, where regulators have high expectations in this regard, but the principle is universally true.

Adversarial relationships (say between executive and non-executive directors) can be necessary *in extremis*, but in normal circumstances they are death to effective governance. Hostility can't be reconciled with constructive engagement, though experience suggests it's all too compatible with a failure to get good answers or even to ask the right questions. Indeed, an atmosphere of suspicion usually reduces openness, and can encourage directors to develop narrow obsessions rather than cultivating a broad view of the business.

Grounded trust is a concept which rejects both antagonism and docile confidence. Its main elements include:

A thirst for significant information and considered opinions, with messengers welcomed, not shot.

Clear procedures for verification such as internal audit, risk management and internal control monitoring. Trust is maintained by a continuous stream of clear, regular, coherent board information and briefing, all open to checking.

An atmosphere of challenge and debate. Trust does not always mean consensus, let alone cosy back-scratching. Hard questions should be asked, tensions will sometimes arise. But trust does mean…

…mutual respect between the board and management. That manifests itself in good manners (so basic a thing, so easily overlooked) and in real dialogue, which involves hard listening as well as straightforward talking.

A Basis for Trust…in Key People

If directors aren't able to place trust in the individuals who matter most and in the management team as a whole, they will struggle. But what criteria should the board use to assess senior managers? And what characteristics need to be consistently evident in management for a board to have grounded trust?

Attitudes

Deciding how far people can be trusted involves registering what is sometimes waved off as 'mere etiquette'. Where executives listen well, consider other people's opinions (even when they think them misguided), and respond to requests, a board's trust is more likely to be well-grounded. Obfuscation, dismissiveness, railroading or unresponsiveness will indicate arrogance, insecurity or deafness to other points of view. Such behaviour should raise serious doubts about how far a manager can be relied upon. And the higher up the organisation it reaches, the more dangerous it is. Sometimes the problem can be mitigated by some sort of work-around: sometimes it can't.

Competence

A history of delivering is a good starting point. But even the best executives sometimes make mistakes or misjudgements. The way they react to failure will tell you useful things about them. Do they take responsibility? Look for useful lessons? Respond defensively or try to shift blame elsewhere? Do they begrudge explaining why targets have been missed? And do they argue a bit too much for the reward goalposts to be moved?

Depth

Boards are often tempted to put all their trust in the CEO. But 'bench depth' matters too: the day to day effectiveness of the senior management group, and its sustainability, are of fundamental importance. Scrutinising their performance and characters (not least by making time and taking opportunities for informal conversations) is essential, as is a clear and practical succession plan for when people leave. In fact, the absence of any credible successor is often a prime indicator of a dominant CEO.

Ethics

Alarm bells should ring at any sign of managers engaging in unethical behaviour. 'Inappropriate' expense claims, bullying of employees and questionable actions: such things have to be dealt with, not brushed under the carpet. The board also needs regular reporting, based on clear indicators, about behaviour combined with getting assurance over the picture that's presented. So as well as setting its own good example, the board also needs regular reporting, based on clear indicators, about behaviour amongst the main body of staff.

A Basis for Trust…in Internal Processes

Directors also need confidence that the processes are working: these underpin and guide people's behaviour. They can be identified and assessed more easily, even though it's the behaviour that often will ultimately be the overriding factor. To rely on them directors need a clear picture of how they are supposed to work – and how well they continue working in practice. So to establish grounded trust a board needs to know about…

Accountability and escalation

Is there a positive culture of accountability throughout the company? Are the monitoring and reporting systems sufficient to enable proper accountability? Do failures and difficulties come into the light before there's a crisis?

Risk assessment

Boards inevitably have to focus on a relatively small number of strategic risks. They need to be confident that this selection is the product of a sound assessment process; that other significant risks have been identified and matched to well-crafted response plans; that priority is being given to managing the day-to-day risks as well as to the big or ugly issues – recognising that it may well be a business-as-usual operational matter that has the potential to cause reputational damage; and that the board's attitude to risk is reflected in the risk-awareness of managers and employees across the organisation.

Assurance and compliance

Without the discipline of reliable monitoring, processes will deteriorate. Transparency is good but not enough on its own: assurance and checking functions must be highly visible, reliable, and looking at enough of the right things. That means boards should keep in regular contact with managers responsible for overseeing operational controls, and ensure that there is good reason for continuing to rely on them.

Crisis response

The board needs to know how the organisation will react when things go seriously wrong, and have scenarios for the more foreseeable types of crisis (many of which will have the same basic elements). This entails setting individual responsibilities, providing for information flows and having procedures for issuing statements within the company and to the wider world. Contingency plans should be regularly reassessed in order to gauge their continuing relevance and readiness.

Making the Right Strategic Decisions

The decision-making processes do matter, although not nearly as much as how people act, individually or collectively, within them. Understanding a board's effectiveness means looking at how directors maintain the right posture for decision making. That means they are understanding current weaknesses as well as strengths, and is as much about mindset as technique. The proper blend creates a bias towards well-rounded judgement.

As part of an effectiveness review this isn't, of course, about second-guessing the board's decisions. It's about looking at how the board goes about making those decisions. And being effective in that involves …

Having a shared sense of direction

Pursuing very specific targets can sometimes do more harm than good particularly in complex businesses where unforeseen consequences can be expected (not as oxymoronic as its sounds), or where circumstances and risks change but targets don't. But nonetheless every board needs to have a shared sense of purpose for their organisation. What sort of business do we want to be? What is the direction of travel? What are the obstacles and hazards to be negotiated along the way? What sort of capabilities need to be developed if we are to be successful? How do we measure progress? Without explicit discussion of these matters, board time and energy can be squandered on debate around unstated differences of priority.

Setting the big decisions in their context

Bad decisions are often decisions made out of context. Individual proposals need to be related to the whole context not discussed as if they were freestanding. There's no better way to multiply uncertainties! The most brilliant plan must be factored into the growth equation, which means understanding how it links, or conflicts, with other projects. Without this, there's an increased risk of the organisation overreaching itself through overlooking its limitations and constraints. Or – which can be just as bad – neglecting its core business while in pursuit of new opportunities.

Retrospectives: how decisions turned out and why

Boards like to look to the future. It can be uncomfortable to look back at things which didn't go as well as expected (often corporate-speak for things which went horribly wrong). But there's a lot to learn from retrospectives, and that's as true for boards as for the managers they supervise. And it can be just as useful to explore why a plan went right: the causes of success are sometimes different from what we have supposed. Choosing a few decisions to reflect on every year will either highlight ways to improve decision making or (just as usefully) support grounded trust in the decision-making process.

Real debate

One can't exaggerate the importance of genuine boardroom debate. Rigorous cross-examination is the best way to discover whether a proposal makes sense (and contributes much to the formation of grounded trust). Looking for gaps and probing the assumptions is a highly positive exercise, but success requires the questioners to be genuinely open-minded and to avoid badgering. Conversely, it needs executives to welcome the opportunity to have their ideas firmly tested. The chairman has a crucial role to play here – sometimes a very difficult role, but absolutely vital. And, at the end of all the discussion, the board needs to go away having a clear idea of what's actually been agreed: again, it's up to the chairman to make sure that diversity of views has not resulted in incoherent outcomes.

Mix and fit of board members

Decision-making at board level means meshing the opinions of people with different skills, experiences and temperaments. Diversity of style and perspective is a great asset – but only if the mix suits the needs of the organisation, and if the group fits well together and demonstrates a high degree of mutual respect even when there's disagreement. If this isn't working it can be a tricky thing to fix, but shying away from it because it's disagreeable won't give the most effective board.

Executive succession

One of the most important strategic decisions – some would say the most important – and one of the most often neglected is executive succession. More than anywhere else, this is where everything comes together: trust in management, uncertainty, the outside world and the future direction and shape of the organisation. It's also the most difficult, because it's entirely about people (although sometimes complex processes are used to obscure this basic truth) and consequently is very unpredictable and with a high potential for unwelcome consequences. Nonetheless, it's a nettle that needs to be grasped. Just what that means in practice is far too big, and too situation-specific, a question for us to offer a glib and easy answer here.

Looking Beyond the Boardroom

How well does the board listen? We all find comfort amongst 'our own sort of people'. There's no harm in that so long as it doesn't turn into tribalism. But there's trouble ahead when a board starts to prefer its own company. The directors will then have succumbed to 'control delusion', the fantasy that a business always determines its own fate.

Actors outside the boardroom – employees, shareholders, analysts, journalists, regulators and campaigners – have a profound influence on reputation and therefore on share price. They have made or ruined chairmen and chief executives, with the flak at times hitting other directors too.

An effective board tells the story of what it has achieved and where it is going in an engaging and convincing way. But it is also a board that actively listens, communicates and converses with those actors and has this as a distinct objective. A clear and persuasive basic message is a necessary but not a sufficient condition of good relationships. There needs to be a pro-active, two-way dialogue and a commitment to think hard about what comes down the pipeline. That's not always easy and it's particularly frustrating when you can't see that the other side wants to join in. But in most cases making the effort pays off. Even if it doesn't get reflected in the share price, it reduces the risks of misunderstanding and will make investors more ready to give the benefit of the doubt when things don't go to plan.

Understanding what external audiences think

It's tempting but usually unwise just to assume that outside perspectives which differ from the board's are simply mistaken. Even if they are – and often they aren't – boards should treat that external commentary as an additional source of information which can at least enrich, and possibly alter, the board's internally-derived perspective. Reaping the benefit requires a mechanism for recording, analysing and synthesising what is said in the media, to a complaints unit, an HR department, or even directly to board members. Reports should be presented in a structured way so directors can assess what stakeholders' priorities really are, and what the response should be.

Explaining and persuading

How well does the board tell the corporate story? Companies usually know what they want to communicate but those on the receiving end won't be very interested in the message unless it sheds light on the questions they care about. Are they, for instance, helped to see how performance relates to strategy? Narrative reporting is often treated as a poor relation but this form of storytelling can deliver immense reputational value – so long as it doesn't become spin.

Distinguishing short and long-term goals

Many investors may take a short-term approach but it's up to a company to set short-term objectives within a long-term context. The board needs to be clear on the difference; only then can it serve as a proxy for investors in testing the quality and persuasiveness of its messages.

Listening to the organisation

Too often boards neglect to hear what the employees are saying. It's not a matter of canvassing second opinions or going behind the CEO's back. But employee surveys, walks around the shopfloor and judiciously-chosen lunches can often give directors a sense of how far things are heading in the right direction – or act as an early warning indicator of looming problems.

THE ENABLERS

Meeting its fundamental objectives is the core of effectiveness. But a board has to be set up for success in the way that it runs. The processes and structures – and, especially, how they facilitate the human interactions – are as vital to board effectiveness as good plumbing is to our homes. A good company secretary will make a difference but here matters stand or fall with the chairman who must act as ringmaster, providing leadership and management skills in making sure the enablers are in place.

The right people

Having the right people around the table – and getting them to come together as a group – is the heart of the matter. Individual experience matters of course, and core business areas and operations need to be covered. But it's also about peoples' characters, the way they work together, how they fit into the culture, the communication styles and personal commitment. Do the different styles and personalities stimulate each other? Is there at least one who's never too polite to ask the awkward but essential question? The chairman needs to monitor and nurture this blend constantly. Recruitment is where it starts, but it doesn't end there.

Atmosphere

Creating an atmosphere conducive to sound decision-making and oversight isn't easy, merely essential. Group-think is fatal: individuals must feel free to question and express opinions but can't be allowed to dominate discussion, or inhibit others. The chairman's role is crucial, but so is the CEO's. Together they must set the tone and lead by example, if the essential mix of constructive challenge combined with pulling in the same direction is to be maintained.

Structural organisation

The visible organisation of board structures isn't closely correlated – if at all – with effectiveness, but it can have a big effect on efficiency. It's behaviour that makes for effectiveness, but good structural organisation makes the behaviour easier and more likely. That doesn't necessarily mean textbook structures: sometimes creativity is needed to make the most of strengths and make up for weaknesses. And it is certainly possible to have too much of a good thing: overindulgence in organisational structure can lead to things not getting done because it's too easy to assume that someone else must be doing it.

Supportive structures

We're not only talking about the company secretary here. It's also about the way management prepare for board and committee meetings, clarity over who's doing what, the thoroughness of the pre-board-paper thinking, the effectiveness of the executive committees in checking that proposals and reports make sense, and individual executives understanding what governance is about and taking responsibility for their part in it.

Communication between meetings

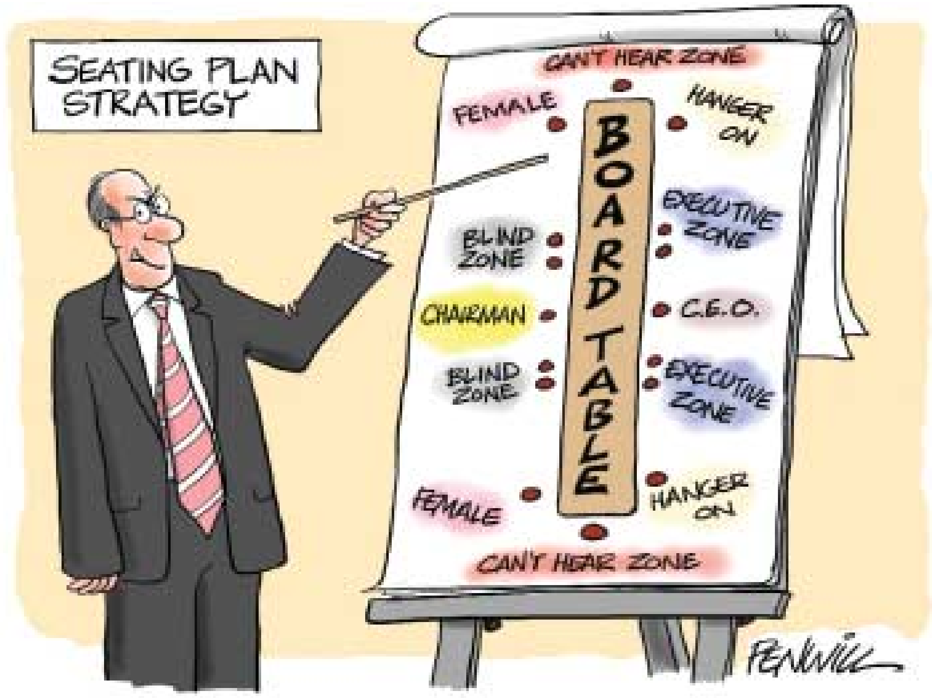
Directors need to be kept informed between meetings about significant developments. Crisis issues need an immediate briefing. And procedures for convening, holding and minuting one-off meetings must be clear. Even at short notice meetings, directors can't be expected to make good decisions if management hasn't set out the arguments beforehand.

Decision-making processes

A board needs to strike the right balance between giving proper consideration to important decisions and being a bottleneck. Moving on a proposal so slowly that the opportunity is missed is a time-consuming and demotivating way of rejecting it. But on the other hand, approving a big decision in a rush is a well-tried route to disaster. Careful organisation of the decision-making process is needed to steer the ship safely between these two hazards: involving the board early, keeping everyone informed between meetings, getting genuinely independent advisors in at the right time, ensuring that questions and concerns are properly dealt with no matter how inconvenient they might be, designating someone to play devil's advocate…

The 'hygiene factors'

Good administration matters. Consider the frustration, friction and impaired decision making which result from poor timetabling and excessively long meetings, too much time spent on operational or procedural matters, unclear responsibilities, conflicting reporting expectations, inadequate secretarial support (especially between meetings) and uncertainty about agenda setting. Room ambience and seating plan matter too, basic though they are – don't expect the best discussion if some directors can't hear everything that's said.



Information

Quality not quantity is the watchword. Executive summaries setting out the history, context, key points and items for decision are vital. Good signposting helps directors to see what matters. Data and charts need supporting written narrative if key points are not to be lost amidst the noise. And directors need time to digest the briefing material before a meeting.

Most importantly, executives need to appreciate how different non-executives' information needs are from their own. Executives are steeped in the practical reality of the business, have all the history and context at their fingertips, and have operational responsibilities which demand detail. Non-executives have intermittent involvement, need to absorb board packs from multiple and usually quite different companies, and are expected not to get involved in operational matters. Giving them last week's executive committee presentation and a hundred pages of detailed management accounts isn't really very helpful.

Getting out and about

Dropping into business units, site visits and chats with local management and employees help directors form better judgements about control, ethics and morale – all important aspects of developing and maintaining grounded trust in management. Red-carpet visits have their place but directors also need the opportunity for informal conversations where people can express their real views and concerns.

BROADER AND DEEPER

Boards need to be confident that they are working on secure foundations – on a solid organisational base. That means thinking about the accountability systems, the governance and assurance processes, and the people below executive director level.

Boards themselves often don't think enough about how the other parts of the governance framework might change to make governance as a whole work better. And effectiveness reviews tend to look at the board in isolation from the structures within which it's operating.

Assessing the whole structure

A board's effectiveness cannot be isolated from the framework within which it operates. Directors need to know that the individual components are working well, both individually and as parts of the system.

We expect to see more boards undertaking reviews of the effectiveness of their entire system of governance, either in part or in whole. Examples of particular angles include:

- Executive and board reporting that gives confidence strategic objectives are being met, that surprises are avoided and that there are clear indicators as to where and when changes need to be made.
- Control and assurance systems which maintain discipline over business as usual, probe for weaknesses in operating systems and processes, and monitor and manage emerging exposures.
- Compliance systems which apply laws and regulations correctly, police internal rule-keeping and mitigate reputational risk arising from carelessness or non-ethical practices.
- Project governance procedures to ensure that both major investments and peripheral operations receive objective oversight.
- Behavioural audits to provide information on whether employees at every level are adhering to the company's rules and principles, and are behaving responsibly to customers, suppliers and each other.

Focusing the board review

Board reviews needn't cover the same ground every year. Few things change much in that span of time. An alternative is to focus in more depth on specific areas. These could be areas that have been identified for further action, or which are so complex or fundamental to a particular board's effectiveness that they demand closer examination.

We expect to see more boards intersperse their wide-ranging reviews with periodic 'deep dive' reviews. These could include helping the board to:

- Obtain a complete view of the control environment and risk governance framework, along with the sources of assurance and their alignment with the risks.
- Change the format of board reports to paint a clearer, easier to understand picture of performance in the context of strategic objectives and business drivers.
- Improve focus on non-financial drivers in order to provide a more reliable assessment of risk and longer-term performance.
- Improve boardroom discussion through adjusting group dynamics and finding new ways to make the most of the skills and characters around the boardroom table.
- Understanding and improving the contribution made by committees at board and/or executive level.

EFFECTIVE TOMORROW

It isn't enough to ask whether a board is effective in today's circumstances. It's also necessary to ask whether it's well-positioned to support the strategy its executives have so painstakingly put forward.

Today's highly effective board might not cut the mustard a few years down the road. Change is constant so the question 'is our board effective?' needs to be coupled with another: 'what will our board need to be effective, given the demands of our strategy and likely changes in operating conditions?'

Strategies may need to alter in line with new markets, evolving technologies, shifting sales channels, new products, regulation and a dozen other factors. Risks will emerge or morph as a result of changes within the organisation as well as extraneous factors such as social and political expectations, capital and credit market developments and the nature of the competition.

Some of these changes creep up slowly and then rise to full flood with disorienting speed, overwhelming organisations which leave the future to look after itself. Others are hard to predict in much detail though there is often a sense of their general tendency. A board effectiveness review should therefore focus on asking, and helping answer, questions about basic pillars of board governance. For example:

- Do we have people with the right skills for tomorrow's likely challenges? Not just for the process of change, but for what the company is evolving into. Will we need more IT expertise? More – or less – political experience? Direct knowledge of expanding geographical markets?
- What oversight will be needed? What sort of control and risk management systems should we be considering? How is the control environment affected by changing cultural profiles?
- How will accountabilities change? What does it mean for the formal reporting lines? Does the board need to be talking to new sets of people within and outside the business?
- How might our investor base change? How will communication be affected? Do we need greater focus on political, legal and cultural risks?

Asking such questions today means a board can start implementing changes in good time. The succession plan can be adapted. Assurance, information flows and reporting can be restructured. Oversight can be realigned with changing risks and accountabilities.

By thinking about what's going to be needed for the future, a board which is effective today has a fighting chance of still being around to be effective tomorrow.

A FINAL THOUGHT

Being around tomorrow isn't guaranteed, of course: the combination of uncertainty and dependence on people means that things can – indeed, will – go wrong. And the necessity for taking risk means that sometimes bets will be lost. But an effective board will greatly improve the odds, both of succeeding and of surviving failure.

Effective board governance isn't the magic bullet that some commentators would like. But in this imperfect world, it's the best we're going to get… and a great deal better than the alternatives.

As long as the constraints are recognised and expectations are managed, boards can make a real contribution: at the least keeping companies on the straight and narrow – and at best helping them onwards in a good direction.

Doing this means constantly asking what the board is there for, what's needed to set it up for success now and in the future, recognising the complexities and ambiguities it must deal with, and acknowledging its interdependencies with the governance frameworks. All interlaced and underpinned with the unrelenting recognition that, more than anything else, boards are about dealing with uncertainty and human nature whilst maintaining decisiveness and direction – a difficult balance to achieve.

For board effectiveness reviews to be of value and to avoid getting stuck in a resented rut, those involved need to keep this in mind – whether it's the chairman who must make it all hang together, the outsiders asking for reassurance on how well the board's working, or the reviewers tasked with helping secure a better understanding of that complex human equation known all too simply as "the board".

We hope this paper, based on insight from many reviews over the past ten years, has stimulated your thinking and perhaps given some ideas. We haven't mentioned everything. Indeed, the more we learn from working with boards, the more we realise there is to know. But knowing that is a good place to start.

INDEPENDENT AUDIT LIMITED

Independent Audit are leading advisors on board, governance and assurance effectiveness. We have worked with many FTSE100 and FTSE250 companies, pension funds, charities and public sector organisations. We provide independent reviews of the board, committees, risk governance, internal audit, external audit and control culture and assess how the different parts of the governance structure are working together.

Thinking BOARD

Our web-based governance service, ***Thinking Board***, provides an easy-to-use alternative approach to reviewing effectiveness across all these aspects of governance. It can be used for internal self-assessment or as part of an externally-facilitated review, drawing on our experience and ensuring that all the angles are covered in a way that provokes fresh thinking.

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