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A GLS BRIEFING NOTE

THE FOUR LEVELS OF MATURITY IN A BOARD:
A Map For Board Development

The Proposition

That there are four levels of maturity through which all boards need to develop before they can prove their competence and professionalism. Given an increasingly sceptical public view of board competence a conscious development process is no longer a choice but a necessity.

Context

Chairmen, Boards and Directors are in a paradoxical position. On the one hand the public, politicians and stakeholders are angered deeply by boards' perceived lack of competence especially since the Western Financial Crisis of 2008. The public now demand higher standards of accountability and professionalism from boards across the listed, private, public and not-for-profit sectors. On the other hand Boards and Directors often resent such charges because they feel that they are rarely properly resourced or trained to accept the increasing responsibilities and liabilities demanded of them. This is understandable. It is an open international secret that boards are rarely fully competent because so little time and money is invested in developing them. Their role is not understood nor appreciated by the public. Yet boards feel that they cannot admit this open secret because of the public's underlying assumption that directors must know what they are doing - or why were they made directors in the first place?

A second paradox follows; despite the public demand for effective corporate governance - delivering the board's two fundamental roles of giving the business overall direction to ensure its future whilst simultaneously ensuring that it is under prudent control – it is widely considered unnecessary to invest any money or time to ensure such competence. The public and stakeholders see this as an unnecessary expense, and few directors expect that they should be assessed regularly on their competence, so why invest?

Moreover, in the current increasingly bitter public debate over effective corporate governance neither side feel that they can be seen to lose face by admitting this open secret without deep political and societal repercussions. So there is an impasse. Currently The Fish Rots From The Head (1) and we need urgently to take action to Stop The Rot by Reframing Governance for Directors and Politicians (2).

The Four levels Of Board Maturity

I have been working on the Development and Review of boards of directors internationally for over 25 years. Looking back on the hundreds of boards with whom Sally, my marital and business partner, and I have worked internationally, we see a lack of a basic map for board competence development – a need to identify and codify the *developmental maturity* level of a board before deciding the appropriate processes for its review and development.

We have identified four levels of Board, and Chairman, developmental maturity. We highlight these for discussion with our clients through this Briefing Note and welcome any responses on infinity@garrattlearningservices.com

Level Zero: The Accidental Director and The Accidental Board

Sadly, this is the default position internationally. Most legislatures insist that on the legal formation of a company one or more persons register as 'a director'. There is no insistence that they prove their competence in this onerous role nor that they even understand the corporate and personal liabilities to which they have contracted. This applies as much to small businesses, start-ups, family businesses and, sadly, charities. Many such 'accidental directors' are later horrified to find that from the moment of their signature as registered directors they are locked into a 24 hour seven days a week commitment including corporate and personal liabilities. 'Directing' is not just attending the occasional board meeting, it is a continuous job for which most are unprepared professionally and emotionally.

But this is also true of the larger corporates and their subsidiaries. Often well-performing executives are asked, or told, to become a director on their own or other boards. Initially, this is usually considered by them to be a great honour and a career high. Frequently, it is then found to be the reverse, indeed often a constantly demotivating career and personal worry. Why?

The Differences between a 'Director' and an 'Executive'

Few executives realise the fundamental legal differences between being 'an executive' and 'a director'. Yet the roles of directors, not executives, are the basis of Company Law. It is commonly assumed in-company and by most stakeholders that executives are the supreme beings in an organisation, with the Chief Executive at their head. This is wrong legally. Such ignorance erodes the supremacy of the board of directors and reinforces the myth of the Chief Executive as a god-like being. The ultimate responsibility for a company's actions sits with the Chairman of the Board of Directors. The Chairman is the 'boss of the board'. The Chief Executive is 'the chief of the day-to-day operations of the business'.

Such knowledge of the board's supremacy is often greeted with disbelief by executives. Matters are made worse when an executive joins a board and are expected by law to learn these new directoral roles and values, and to accept levels of liability 24/7. Again, such knowledge often challenges the personal comfort of new directors when their responsibilities and liabilities highlight the implications and risks for their future family wealth. Such ignorance, or refusal to accept, is no defence at law. Ignorance does not allow them to avoid their directoral responsibilities and liabilities once they have signed the Companies Register as a director. They are bound legally and often only realise this too late – when their liabilities and responsibilities are being questioned at law. It is then too late to accept being a director means developing and demonstrating specified competencies. They have become an unwitting Accidental Director; and often on an Accidental Board. What can be done to move from this dangerous Level Zero?

Actions needed to escape Level Zero:

Accidental Directors face a stark choice. Either, a director refuses to acknowledge the legal position and hopes never to face the consequences – a very high risk strategy which rarely seems so at the time.

Or, they accept that they must obey the Company Law on the general duties of a director and start a process that allows them to become at least minimally compliant.

Level One Board Maturity: Grudging Compliant Complacency

Once directors accept their role and liabilities through induction by the Chairman and Company Secretary, it is human for new registered directors to say 'OK, I may be uncomfortable with what I have signed up, but what is the minimum I now need to do to make this new role a success?'. They will seek the cheapest programme to become minimally compliant. This is the classic 'tick boxes' approach. It has no developmental aspect to it as it is not linked directly to board and business performance. It is grudgingly accepted as an additional cost imposed by regulators, politicians and bureaucrats, but without any reciprocal developmental benefits. It is a negative and defensive mindset yet exceedingly common. The details of such compliance are listed under *The Basics* below.

It is possible for a board to exist in minimum compliance mode. Indeed, in the US this '*CRG'* mindset - a focus on minimal Compliance, Risk and Governance – is common. But since 2008 boards are under increasing challenge internationally by irate shareholders, stakeholders, regulators and legislators to stem their professional under-performance and demonstrate their competence. This is highlighted in the current auditing and accounting scandals. The perceived lack of professionalism in corporate directors, auditors, accountants and lawyers, combined with the rising demand for Integrated Accounting, '*ESG'* (Environmental, Societal and Governance) reporting by a board, shows national demands for more Inclusive Capitalism and ethical behaviours. These are forcing boards to face the proposition that 'directing' is a proper job, distinct from the executive role, that demands professional development and assessment with funding to match. It is an entrepreneurial activity that demands taking considered risks where failure has increasingly corporate and personal repercussions.

The Basics

To begin the move from complacent compliance there are two building blocks on which effective corporate governance is being built internationally. First, resolving '*The Directors' Dilemma'*. This poses the basic question for any board – "how do we drive our enterprise towards a healthy future whilst keeping it under prudent control?". This sounds deceptively simple but it needs balancing and rebalancing continuously around the boardroom table. This is why directing is 24/7 and why we need to develop board competences to focus primarily on resolving this dilemma. Many compliant boards fail at this first hurdle. They do not seeing their role as dynamic. At worst they see it an imposition on their executive time to have to turn up to, say, four board meetings a year. They will be looking at their mobiles below the table to see the earliest times of their return flights so that they can get on with their 'proper' jobs of managing.   This is unacceptable directoral board behaviour. Compliance alone is not sufficient for competent boards.

Second, boards need to understand and then commit to, '*The Seven Duties Of a Director*'. Two things astonish us here. First, the similarity of Director's Duties currently prescribed around the world. Second, the inability of most directors to quote more than two of them. They are rarely seen as the basic architecture of a director's job. yet this is exactly what they are. Anything not built on these foundations will fail. For the sake of clarity they are:

1. To act within their powers (the constitution)
2. To promote the success of their company
3. To exercise independent judgement
4. To exercise reasonable care, skill and judgement in their decision-making
5. To avoid conflicts of interest
6. To declare interests in third party transactions
7. Not to accept benefits from third parties. (3)

Again, these sound deceptively simple. Understanding what 'Care, Skill and Diligence' means for a board takes time to agree and develop. 'Independence of Thought' is more tricky. At law a registered director must be a free agent able to decide independently what is best for the business – to which they must demonstrate their *primary* loyalty. But if a director has been appointed as a representative of a block of shareholders, or stakeholders, and feel that they must act according to those wishes, rather than exercise their independent judgement, then this is unlawful. (4) Most directors do not know this, especially if they are stuck in the Accidental Director mindset. Many think that their election or selection is merely as a representative of other more powerful parties. When they become aware of the law then great personal tension can be created. This is an answer that many do not want to hear.

Coming to terms with this reality is what releases, or blocks, board development and the necessary step change in maturity that enables the creation of a professional board.

Actions needed to progress from Level One:

A developmental programme for the board and each director with a focus on learning

Committing to living the Directors' Dilemma and the Seven General Duties of a Director with an annual assessment of these. This builds the foundations towards a more professional board.

This is helped greatly by an initial Board Review process to create outline development plans for the Board, the Business and individual directors so that the Board can move to Level Two maturity.

Level Two Board Maturity: Towards The Learning Board

A conscious move to Level Two (The Learning Board) maturity signals a significant change of mind-set and commitment to directoral competence by the Chairman and all directors. It is a move to diminish the dominance of ‘executive thinking’ and to rebalance board time towards ‘directoral thinking’ – Policy Formulation and Strategic Thinking.

To do this well it is crucial to agree around the boardroom table, and with the Executive, a key document – *The Reserved Powers of the Board*. This makes explicit the supremacy of the board’s powers; usually in such areas as who appoints the Chairman, who proposes directors and selects senior executives, who has the final say on capital expenditure above agreed limits, who determines the Business Model and Strategy, through to who has the final say on such issues as media releases. Such clarity gives business performance focus to each party and much reduces the chances of later major confusion and splits between the Board and the Executive.

To reinforce the distinction between directoral and executive roles we have found it helpful for executives to have two distinct types of contract. We advocate a Contract For Services for all registered directors, including those executives who are also registered directors. This puts all directors on an equal basis of rights and duties. For executives we advocate an additional Contract of Employment for the, say 80 to 90% of their time as an as an executive. This highlights that they are two very different roles which are paid, developed and assessed separately. This helps greatly develop their independence of thought and clarifies their need to develop new levels of Care, Skill and Diligence.

Once the Directors’ Dilemma and The Seven 7 Duties are agreed and under development, focus can then turn to ensuring that the board moves from trying to ‘manage from the boardroom table’ (wasting valuable board time by second-guessing the executives) to concentrating their main focus on to the *Four Main Tasks Of A Learning Board*: (5)

1. Policy Formulation and Foresight
2. Strategic Thinking

3. Supervising Management
4. Ensuring Accountability

It often requires external help for a Board to move the new thinking required into a ‘helicopter view’ of the business: away from the usual internally (executive) focused prioritising of Accountability and Management Supervision towards necessary externally-focused thinking and directoral decision making. This focuses on Policy Formulation, Foresight, and Strategic Thinking. This is where the Board's understanding, imagination and risk-taking is tested against the messy, complex and changing external and interlinked dynamic environments of Politics, Physical Environment, Economics, Social and Demographic trends, Technology advances and World Trade. It is the stress testing of the Business Model. Few Boards do this in any rigorous way and rarely demand the resources needed to do this well.

It is for the Chairman aided by the Company Secretary to oversee this rebalancing process. The transition is helped by developing a *Board Dashboard* that shows visually the monthly trends on key business indicators within agreed upper and lower limits of acceptable deviances. This reduces greatly the Board's need to second guess the executive from the boardroom table, especially on operational issues. Most importantly it releases significant Board time to concentrate on Policy Formulation and Strategic Thinking to better ensure the long-term health of their business.

The Learning Board model encourages a dynamic board to design an annual plan which, at a minimum, abandons a standard agenda format and starts its year with a Board meeting focused heavily on Policy Formulation in relation to the messy, uncertain and ever-changing external world in which it maintains its viability. Few boards design this key time to become sensitised to their company's changing needs in their changing external environments. But without a concentration on it at a Board meeting at least every three months it is impossible to develop the Business Model and so test current Strategies.

The development of the Board's and individual director's strategic *thinking* capabilities is an essential part of moving to achieving Level Two Board maturity – the basis of the Learning Board. Diminishing the Board focus on Supervising Management and Accountability is helped greatly by viewing at least monthly the deviances shown on the Board's Dashboard, but agreeing to debate only the crucial changes seen, rather than have warm and waffly repeats of issues of which everyone is already aware.

Actions needed to progress from Level Two Development:

Agreement and commitment to develop a Learning Board, starting with the Reserved Powers of the Board.

Refocusing and developing the Board away from Executive thinking towards more Policy Formulation and Strategic Thinking

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Creation of a Board Dashboard to test the Business Model.

Agreement on the annual rhythm of Board meetings.

Consequent agreement on Board Selection, Induction, Development, Assessment, and Deselection processes.

Level Three Board Maturity: Integrating The Learning Board with the Learning Organisation

Becoming a Learning Board within two years is a demanding yet achievable target. It frees time and energy for the Board and the executives to fulfil their proper roles, especially by taking thoughtful entrepreneurial risks to ensure the long-term health of their business. The final level of Board maturity – Level Three - is then to integrate the *total* organisational structure, processes and climate to free the subsequent internal and external learning across *all* levels of the business. This is not just a nod to such fashionable notions as 'creating a culture'. It is much harder edged than that. The Board commits to encouraging open learning across the organisation that reflects the way the board itself is seen to be learning its role as the central processor of business information and the guardian of its strategy, values and culture.

It is a surprise to many Boards and Executives that such apparently 'soft' areas as culture and learning are measurable let alone that they add value. This is often because the more mechanically-based areas of Management and Accountancy have dominated board thinking processes for so long. It takes a change in the board's mindset to move from a focus on parametric statistical analysis to non-parametric analysis. Such 'soft' analyses reap great rewards because the resulting differential measures harvest better the learning in the business. We have developed a well-tested instrument – The Organisational Capability Survey (6) – which, through tracking the dynamic trends of just twelve organisational dimensions and then publishing the trends of each regularly and openly within the business, creates a learning climate that, over time, ensures a robust business culture – a truly Learning Organisation.

Then a key part of the Board's Dashboard is not just on the 'hard' business results but includes the trends in the organisation's total, including its learning, emotional climate and levels of commitment across the whole. The primacy of the Board in valuing and processing this information is then seen by all as crucial to developing a unique business culture.

Level Three Integrated Development Plans

Moves to ensure openly publish internally trends on the combined learning across the business.

Development of an regular and open Organisational Climate Survey process.

Accept across the enterprise that the board is the central processor of all Business information

In parallel with it being the guardian of its business results and its (measured) culture and values.

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