

The Director

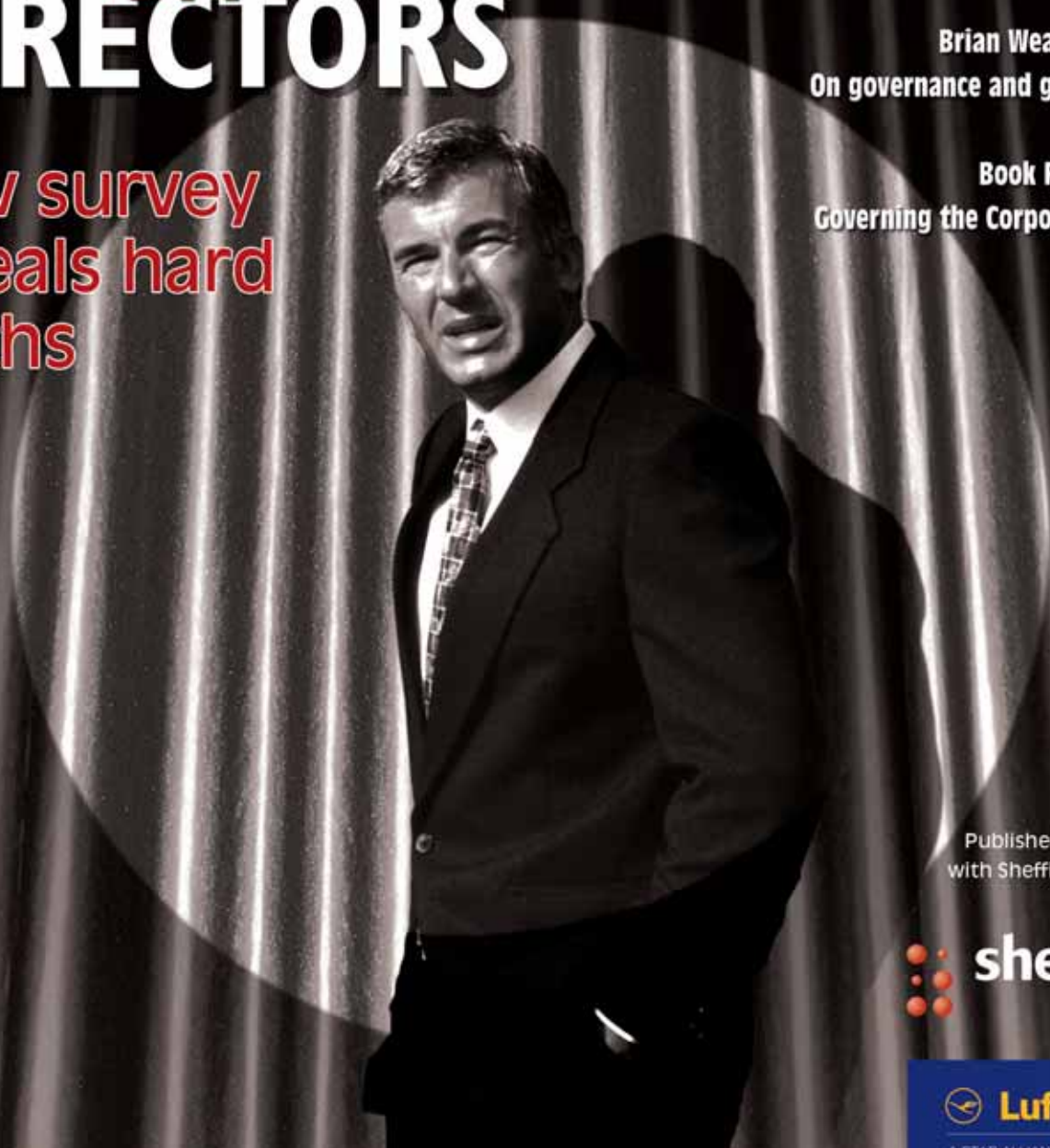
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Governance in Action

COVER STORY 8

SPOTLIGHT ON DIRECTORS

New survey
reveals hard
truths



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SPOTLIGHT ON DIRECTORS

New survey reveals hard truths

Charged with acting as the early trip wires for corporate issues, directors have a few issues of their own to address. According to a comprehensive new local survey, these include their selection and evaluation processes and levels of expertise. It's not a pretty picture, reports Ruth Le Pla.



When a survey of New Zealand directors was launched earlier this year, it aimed to reveal the true nature of the state of organisational governance in New Zealand. Boldly broadcast as the largest and most authoritative nationwide survey of its kind to date, among other things it wanted to know whether New Zealand companies and other organisations have easy access to high-quality directors. Are our boards populated by directors with sufficient competence to do the job, it asked? And, do Kiwi directors believe they are effective?

Jens Mueller, associate professor for entrepreneurship and strategy at Waikato Business School, and company director Sandy Maier are the mainstays behind the survey. They've also got the public support of a raft of organisations. Coordinated by Waikato University's Management School, Mueller and Maier's work is backed by corporate and professional heavyweights that include Simpson Grierson, KPMG, Sheffield, the Bank of New Zealand, the

New Zealand Shareholders Association, the Institute of Chartered Accountants, the Government's Crown Company Monitoring Advisory Unit (CCMAU), the New Zealand Venture Capital Association, Brook Asset Management and *The Director*.

Findings so far paint a fascinating picture of the stresses and struggles inside our nation's boardrooms. While the Directions 2006: Understanding Governance survey remains open to new respondents (see box story "Still filling the knowledge pool") its proponents say the data to date is sufficiently robust to demonstrate some key underlying trends.

"If we had to say in 10 words or less what the survey is all about," says Mueller, "it's that we want to stimulate a discussion." Add to that a desire to provide factual underpinning to such debate. "All too often," adds Maier, "discussion takes place with raised voices and no facts." This "battle of assertions", as he calls it, could, in his opinion, be about to end.

PERSPECTIVES

"Excellence in corporate governance is vital to long-term investor confidence and participation in capital markets. We believe this survey will highlight areas of deficiency in terms of investor expectations and actual practice. We would expect to use the survey results to encourage corporate New Zealand to improve governance standards."

– Simon Botherway, managing director, Brook Asset Management

"This governance survey is quite unique in the New Zealand context. As a small and increasingly diverse economy our governance arrangements in terms of their diversity need to be better understood. As a result we can plan more judiciously for more sophisticated governance structures in the future."

– Ian Taylor, partner, Sheffield

"Without good governance an organisation is rudderless – there is no role more important than leading and monitoring long-term strategy and direction."

– Phil O'Reilly, CEO, Business New Zealand

"This survey will help organisations come to terms with what is generally appropriate in this country's business environment and where the focus needs to be – on attracting skill, diversity, independence and a global perspective."

– Shelley Cave, partner, Simpson Grierson



Simon Botherway



Ian Taylor



Phil O'Reilly



Shelley Cave

Take, for instance, the revelation that in the next five years these respondent companies alone will need to find another 1960 new independent directors. Extrapolate that out across the nation's business community and alarm bells start to ring. That's especially so among small and medium sized enterprises – which represent a whopping 96 percent lion's share of New Zealand's businesses and which lack the market magnetism of big corporates when it comes to attracting talent at the top.

Able to offer a heady mix of more dollars, media headlines and stock market attention, big business exerts a stronger pull and will doubtless remain at the sexy end of the directorship scale. Smaller businesses, in no less need for good corporate governance, struggle to attract talent. Indeed, Maier reckons they are already fast approaching a crunch point.

The Directions 2006 survey shows that, across the board, in 40 percent of cases directors themselves find incoming directors. They are the single largest source of new blood. Management follows in the number two slot in providing the link to the next generation of board members. This raises the significant issue of where tomorrow's directors will come from and how business as a whole can reframe its search processes.

Directors are currently selected in a way that most likely will not allow future directors to emerge, says Maier. "Because if Tom, Dick and Harry all go golfing and Tom recommends Dick, and Dick recommends Harry we're not going to have room for anybody new from the outside."

It's pretty clear, he says, that this old "informal, incestuous" way of selecting directors will not work in the future. In any case, he says, when it comes to SMEs, common sense dictates that they cannot afford to source directors through search firms. "They don't pay enough to begin with... so new tools have to come into being."

There is a "virginity conundrum" here too. "Most people say that they want a person with a track record of directorships," notes Maier. "The problem is that not

STILL FILLING THE KNOWLEDGE POOL

It's not too late to have your say. The Directions 2006: Understanding Governance survey remains open. Go to www.worldsurvey.info and click on the New Zealand flag at the bottom of the page. Respondents to date report that it takes around seven to eight minutes to complete the 40 questions. No financially or commercially sensitive data is required.

As this article went to the printers, 2150 people had already completed the survey. About the respondents so far:

- Gender: 79 percent of the respondents are male, 21 percent are female.
- Geographic dispersion: 38 percent from Auckland, 19 percent Wellington, 14 percent other North Island. Others are spread throughout other regions.
- Size distribution: 34 percent of respondents are from businesses with sales of less than \$5 million, 10 percent from businesses with sales of \$5-10 million, 11 percent from \$21-50 million organisations and 8 percent from firms with over \$500 million worth of annual sales.
- 60 percent of the firms are globally active. This would indicate that the majority of respondents might be measured by global governance standards as they compete for business overseas.
- In 55 percent of the firms, the CEO is also a director. In a quarter of the firms, the CEO also chairs the board.

Survey directors Jens Mueller and Sandy Maier would like to acknowledge the work of Waikato Management School's international MBA students: Sascha Worrich, Sandra Blumberg, Pattarin Chaipanich, Pranjal Jadhav, Yin Ng, Thomas Nivert and Donchart Somboon, without whose efforts the survey would not have been possible.

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everybody springs forth from the brow of Zeus having had directorships before. The choice is you either start totally unprepared or you say that preparation in a range of subjects – such as law, finance or sociology, for example – is a good starting point and competencies can be built up... People have to start somewhere and they might as well be

intellectually and academically prepared.”

Mueller says the survey results highlight the current lack of “an open, easily accessible unbiased format” by which directors and organisations can find each other and through which individual directors can find out what other directors are currently doing.

ACTION STEPS

- Maier and Mueller plan to launch a web-based format for matchmaking directorship services. The impetus comes from their perceived need for a more transparent and open director selection process. Right now, says Maier, anybody wanting to become a director has a “fairly limited” number of options. “They could talk to friends and put the word around. They could send their CVs to search firms, publish an article or otherwise raise their profile and hope that indirectly they get somewhere. They could register with the IOD, which [may] have a slot that they’re looking for. Or they could get on the CCMAU list which covers a specialised sector of the company world.” Currently, says Maier, there is “no open, transparent modern form” where all this information is easily accessible in the one place. “It’s therefore very difficult to work out how many search firms are looking for how many directors to fill how many slots. “How many people are on each list? That data is not easily ‘pull-up-able’ and it probably does not apply to SMEs in an effective and efficient way. So we need to find another way – if this data is to be taken at face value – to find a form – probably electronic – where people can post their information.” At the same time, organisations will be able to scan the listings for a match. “Really, it’s quite medieval the way it’s done now. It’s totally opaque. All of this information that could be made transparent technologically, is hidden. We now have thousands of companies and thousands of people who are seeking for thousands of positions to whom that process is not adequate, not effective, not efficient, not possible. Something else must take its place if we want good governance.”

- In isolation from global markets, Directions 2006 is only navel gazing. Maier and Mueller are leveraging Waikato University’s international connections

to take the survey offshore. They now have groups of people in countries as far flung as Singapore and China, Australia, the United States, Canada, Europe, the Philippines and Malaysia, editing the original New Zealand survey for local content and translating it into local languages. The aim is to develop an international scoring system that will reveal how corporate governance at individual Kiwi companies stacks up against that of their industry peers. Significantly, it will also, for the first time, rank New Zealand on a global governance-scoring model that does not just look at the corporate biggies but also includes SMEs. Expect to see the first global rankings being released in August this year.

- Statistics lack meaning if nobody does anything with them. Expect to see the launch of the “Maier/Mueller Good Global Governance” benchmark scoring system – a web-based programme that will allow directors and investors to check out firms they are interested in, and executives and directors to test their own governance effectiveness. Maier envisages a mechanism that will help people freeze-frame their current position and find out how their characteristics, behaviours and aspirations stack up against those of their peers. “This is not fuzzy. It can be measured quite concisely and people can place themselves on a scale.” In Mueller’s mind, it’s a question of risk minimisation. To what extent can an organisation early identify that it is at greater risk than its rivals because it doesn’t have a structure that will allow it to move forward competitively?

- Finally, watch out for the possible emergence of an educational programme for directors. There appears to be no recognition of a training programme or certificate for directorship competence in New Zealand, note Maier and Mueller. “We will investigate whether such an educational programme can be developed.”

Add to that, the finding that 41 percent of the respondents to date say their organisations have no independent directors. This, as Mueller points out, appears to lag behind the global trend of requiring some (if not most or all) directors to be independent and raises questions of the quality of some decisions being made.

“We’re not saying that dependent directors are necessarily bad,” says Mueller, “but they must be schizophrenic so that they can disassociate their personal lives at the firm as a pay cheque recipient from their lives as directors.”

In any case, why would a supposedly accomplished businessperson want to be a director? Directions 2006 shows that top of the list lie the desire and ability to “do some good”. For this bunch of people, at least, dollars are not the key driver. Given New Zealand’s relatively harsh risk profile for directors when it comes to personal liabilities, it comes as no surprise that this bunch of respondents say they want to work for a firm that has a good reputation.

The learning from this, says Mueller, is that some organisations may need to make themselves more attractive to the kinds of prospective directors that they want.

More revealing still, when current directors were asked about their own competence, the only area they rated as excellent was their commitment to the business. As a group, respondents gave the next best marks to their ability to be a team player.

In other areas of factual expertise such as their grasp of legal, regulatory and corporate governance issues they ranked themselves as significantly less competent.

More alarming still, they reckoned their fellow directors were even worse than they were. “That means we have a number of directors who come on board because they feel that it is a great thing to do and they will give it their best,” says Mueller. “But their light is out in the harbour at night, there’s no-one at home and we’re ending up with people who don’t have the right skill set.”

In this sorry state of affairs, New Zealand is not alone. Latest research on board governance in the United States

is distressingly similar. When management consulting company McKinsey wanted to probe governance changes in the United States, it went out to 50 US directors and 44 institutional investors with more than US\$3 trillion in assets under management. Feedback showed that nearly one third of those directors considered their peers to be “barely adequate or worse” as board directors.


In New Zealand, only 40 percent of investors indicate that they are well informed about the corporate governance policies of the firms in which they invest: highlighting, as Mueller points out, a need for help in formulating such policies and raising disclosure issues.

“Only 38 percent of investors,” he goes on to say, “confirm that they receive sufficient information about CEO pay and performance. This indicates an area where companies probably need to improve their shareholder disclosure policies.”

When it comes to attributes and qualities enshrined in individual directors what’s on the collective wishlist? This bunch of respondents reckons directors should have a track record of business success, a good reputation in the market and – logically enough – be capable of forming their own opinions. The least important qualities? Holding a certificate from the Institute of Directors, being an employee and sitting on many boards.

Almost two thirds of respondents told Maier and Mueller that they believe directors’ performance should be regularly evaluated. This raises the issue, says Mueller, of the need for a local evaluation process, benchmark or scale.

Over in the United States, there are signs that board evaluations are gaining traction. Back in 2002, according to McKinsey, a paltry 37 percent of S&P 500 companies were conducting board evaluations: a figure that rocketed to 87 percent a year later.

Given directors’ liking for facts and figures, it will be interesting to see how they react to this new, not-altogether-flattering view of themselves that has been unearthed by Directions 2006. 



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