



The Basic Principles of Governance



Introduction

If you're looking to understand the principles of governance, you have stumbled upon the right ebook. Each chapter will provide new teachings in a very short read. All you have to do is pay attention, take the information in, and stay sharp.

My name is John Page and today's first chapter is based on a conversation I had with my colleague from Boardworks, Graeme Nahkies. We will discuss governance, what it is, its origins, what its key principles are, the role of the board, and more, so you can have a good foundation of knowledge.

What Is Governance?

John: When I think about governance, I think of my career in it, which goes all the way back to the early 1980s. Back in those days, we never really discussed the subject of governance. It's not something we wanted to talk about much because you're either on the board or reporting to it, or you're not. The idea of governance as a discipline simply didn't exist back then.

But then came the 1987 share market crash, which led many high-profile companies all over the world to come crashing down with it. That was the trigger that got people talking about governance. People starting thinking: where was the board? Isn't it their job to protect companies, organizations, and institutions from scenarios like these? Why did they fail?

With that in mind, it's very interesting to think about governance. How can we define what it is? Well, I personally always come back to Sir Adrian Carbury's definition of governance, which is very simple and easy to grasp; governance is all about directing and controlling organizations. We can break that concept down, and we will, but that's the essence of it and it's a discipline that didn't exist 30 or 35 years ago.

What's the Role of the Board?

John: The way I see it, there are some important underlying factors to this discipline. One of them is the idea that the board is expected to exercise leadership but it's not often used in a direct sense. When we discuss the role of the board, it is clear that they are meant to provide a specific form of leadership. Robert Greenleaf described it as external leadership, as opposed to the internal leadership that the executive team provides.

The board is an important component of the overall leadership of the entire organization. It's called external leadership because the board is outside of the organization, so it's independent of the executive process. To put it simply, the board deals with things that relate to the bigger picture the organization is trying to achieve, rather than the day-to-day.



Graeme: John Carver proposes a useful way to look at that by seeing it as a layer of ownership down rather than a layer of management up. This is something that we often see with boards that are only reacting to what's thrown their way and act like a supervisory layer of management that's overseeing the business. In actuality, the board is a subset and it represents the owners of the company. They act on behalf of the owners, so they have the future of the company on their hands and complete custodial oversight.

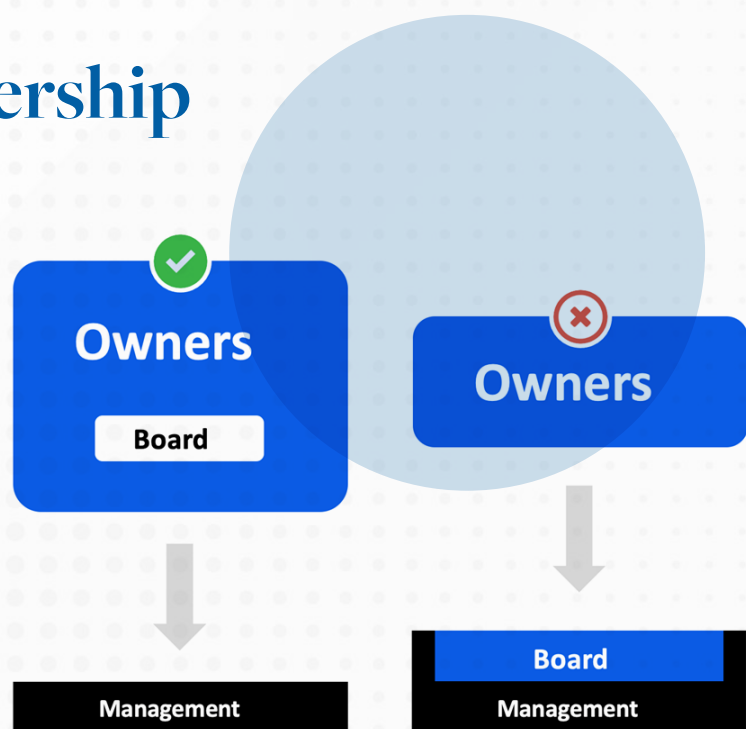
John: As Graeme says, it's all about control and direction. Another way to look at it is, are you on pilot mode or watchdog mode? All boards have a watchdog mode because they are bound by law to stay on top of things such as compliance, oversight, risk, safety, health, and more. All those things are necessary and they need to be done efficiently. But mostly, their focus is on setting a direction, taking leadership, and determining where the organization stands and where it's going.

Graeme: For me, one of the most important dimensions of this leadership role is that the buck stops with the board. When I started in governance roles, we didn't see the board as anything but an entity that is reactive and passive. It's reactive to whatever management initiatives are put forward because they must approve big decisions and oversee things, but mostly in a secondary role. The idea that the board has a primary function is what we're going to explore in this ebook.

John: That's right. We often go into organizations and we try to find evidence of strategic direction and it just doesn't exist. That means the organization and the board are just reacting to what they're being thrown without any sort of cohesive approach. That is a dangerous way of carrying an organization and sadly, we see that way too often. More often than we would like. If you don't know where you're going, you might not get there. That's why it's so important to know and to come up with an approach that will provide certainty that you'll get there.

The Idea of Ownership

John: I think that one of the central ideas we are trying to convey here is that the board is a subset of the owners, not a part of management. Now, the semantics of ownership is not something we should worry too much about. John Carver, who you referred to before, made a distinction between proprietary ownership and moral ownership, and I think that's important to discuss.



Proprietary ownership refers to shareholders, the people who own a piece of the company, while moral ownership refers to the psychological responsibility for the ethics of one's actions and the actions of the people in the organization. At the end of the day, the effective owners are the ones that can influence the composition of the board and the entity's constitution.

Graeme: In recent years, this idea of moral ownership is being extended to the idea of social license. So, the people who are impacted by the work you do and the business you undertake will develop a certain view of you. The license of the community is what gives you the right to operate. So, it's starting to be codified into things such as obligations as they related to climate change, for example. The idea of moral leadership is becoming more important in business because organizations can't exist and thrive in isolation from the community.

What Are the Theoretical Origins of Governance?

John: The theoretical origins of governance are founded in agency theory and financial economics. It's very interesting to see that for the past year or so, we've been hearing about the idea that governance is no longer about the primacy of shareholders and what boards need to start concerning themselves with a wider stakeholder environment. The idea has spread around the world and it has even reached commercial environments. This is because the success of organizations is not solely based on the discussions the owners have.

Graeme: Totally. There's a nice idea I recently discovered while reading a European Union report and it said that the purpose of business is to solve the world's problems, not to profit by creating problems. I find that's a lovely thought and it's something we should always keep in mind. The non-profit environment is already operating only in this space, but accountability is becoming crystal clear across the board.



I think what we've discovered after working in this space for an extensive period of time is that the principles of governance are quite generic. They are not specific to a sector, whether it's not for profit, commercial, or governmental. Rather, they are the principles of a group of people who are collectively making decisions and being accountable for those decisions. As such, they apply similar disciplines when it comes to decision-making, managing relationships between the board and management, and oversight.

John: Yes, that's right. Arguably, companies have specific requirements. For example, a startup company with the founders involved deep in the company is different from others. There are also many different modes of engagement but the principles of governance are the underlying factor in all these things.



Partnering

- Direction setting
- Financial planning
- Risk appetite
- Talent development



Monitoring

- Organisational performance
- Compliance
- Organisational competence and capacity



Taking Charge

- Purpose and values
- CEO selection
- Performance criteria
- Board composition & competence
- Ethics and integrity
- Compensation architecture
- Crisis management



Staying out of the way

- Within delegated authority
- Day-to-day operations
- Non-strategic decision-making
- Excluded by Board Charter

I think that the layer of ownership is important. The other thing is that the board is responsible for creating a future, so it's less responsible about taking care of the shop, so to speak. That's always a good test for the board; to make sure that their efforts are being placed where they should be and their time is being spent on the things that they can influence.



What Are the Board's Responsibilities?

The idea is that the board is responsible for long-term stewardship. So, even though there is a changeover in the membership of the board, the board continues to be a permanent leadership element of the company. Chief executives and their staff may come and go, but the board will exist and remain for as long as the company does. Therefore, the board is responsible for taking initiative and being accountable for things such as the purpose of the organization. We will explore this a lot better later on, but I want to say that it's vital for the board to know why the organization exists.

Graeme: That's correct, and the trustee and stewardship theory is very relevant. It focuses on respecting the work that has already been done, building on today, and planning for the future. The focus of the board is the health of the organization in the long-term, big picture stuff.

John: Okay, so far we have gone through two important principles of governance. The first one being that the organization's owners, whether they're legal or moral owners, have a desire in mind for the organization's work. It's the responsibility of the board to turn those wishes into organizational outcomes. The second principle focuses on the job of the board and how it's separate from management. That's something that needs to be clearly understood. We also like the idea of looking at the board as a leader of culture. After all, the fish rots from the head.

Graeme: Yes, that's right. The idea is that if the board is not functioning as it should, then anything can happen. All bets are off. Why? Because the board sets the tone for the entire organization. They set the standards and they clarify and define the purposes

and goals the organization needs to achieve.

That is separated into ends and means. The ends represent where the organization is going. Every journey needs to have a specified end, otherwise, how do you know what road you're supposed to take or what turns you're supposed to make? It would be impossible. The means refer to what's necessary to get to the end, which is more or less in the domain of management. It's key that the board speaks with one voice and there also needs to be a culture of accountability throughout the organization.

John: Another important point to make is that directors and board members all have fiduciary duties that they can't delegate or neglect. They must fully accept their fiduciary duties so if the board ever needs to go to court to defend themselves, they can demonstrate that they've exercised those fiduciary duties.



To Summarize

John: There are many areas of responsibility that the board is responsible for, such as direction-setting, organizational performance, and more. Monitoring is one of the most important areas because it refers to the thing over which we have oversight. Is the boat going way too fast? How do we know if it is? Of course, certain things in the organization are delegated and defined by the policy.

To conclude the first chapter of this ebook on governance, it's important to make a summary of the core principles we've discussed so far. There's the issue of the board translating ownership requirements and organizational outcomes, which is essential and it's an important starting point. The idea is that governance and management roles should be distinct and properly documented and that the board recognizes the responsibility it has to lead in reference to many different aspects.

The clarity that stems from that is key because it's very important to be clear on what the organization must achieve and where it's going. It's also about delegating to the chief executive and their team so the performance expectations are fulfilled. The board also must be accountable for its own processes and it needs to be thoughtful about what it's doing. How is it going to get the job done? What part of that job is exclusive? How is it going to be done efficiently and effectively?

Finally, the board must largely delegate the operations of the organization because it holds all the constitutional authority to do so. Of course, it's important to have an explicit process for that and the board must respect the delegations that it makes to the chief executive.

Respecting everyone's time is particularly important in boards where people are volunteering their time.

It should be an enjoyable experience and the steps required to make that happen should be taken.

Nobody volunteers and expects to be miserable. If they are, then maybe they're not volunteering their time to the right organization, maybe something's wrong.

I want to thank Graeme for having such a wonderful discussion with me and helping me expand this subject for you all. We both hope you find this chapter useful and that you keep an eye out for future chapters. If you want to learn more, we invite you to visit our website to learn more and access many helpful resources. We have many valuable articles for you and we leverage our experience and knowledge to make the content as helpful as possible.

BoardPro's site is full of resources that will truly help you understand many different topics, so take your time and browse the website. You will find a ton of information that's easy to digest and even easier to apply so you can take full advantage of the benefits.



Recommended Reading

Is it time to revisit your purpose

<https://boardworks.nz/all-resources/is-it-time-to-revisit-the-purpose-of-your-organisation/>

Why do boards exist?

<https://boardworks.nz/all-resources/why-do-boards-exist/>

Sonnenfeld, J A. **‘What makes great boards great’.**

Harvard Business Review 80, no. 9 (September 2002): 106–13, 126.

About BoardWorks



Graeme Nahkies co-founded BoardWorks in 1997, Australasia first specialist governance consultancy. Since then the company has worked with over 600 client across all sectors. Graeme came from a series of senior roles in local and central government. He is now BoardWorks Practice Leader ensuring BoardWorks stays at the forefront of contemporary practice.

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John Page is Managing Director of BoardWorks. His early career was in senior roles across the professional performing arts before leading the highly successful governance programme for Sport New Zealand. With Graeme he writes across governance subjects and particularly enjoys teaching face to face with boards.

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About BoardPro

We exist to increase boardroom productivity and create better functioning boards. We don't believe good governance processes should be left to the domain of larger companies. We know that all parties in a board/management relationship want to use their time and resources most efficiently and productively. We found that a product that helped with the processes, workflows and guidance to work on the right things was missing from the market.

So we developed BoardPro in partnership with some of the best independent directors and most progressive CEOs.



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