Value across the board

Were behavioural deficiencies really behind the recent performance failures in the financial industry? Ali Gill, CEO of Crelos Ltd, looks at whether the recent *Walker Review* will make a significant impact on improving corporate governance – not just in the financial industry but all sectors

"Governance practices are, by their nature, organic, dynamic and behavioural rather than akin to black letter regulation."
Walker Review, November 2009

Sir David Walker's *Review of corporate governance in UK banks and other financial industry entities* was requested by the UK government as the vehicle to understand what prompted the financial crisis and how a repeat of this can be avoided in the future. The final report suggests a series of reforms to improve the quality of boards, strengthen the role of shareholders, and increase transparency of pay and bonus structures. Above all, Sir David identifies a clear link between board behaviour deficiencies and poor business performance.

Enlightened chairmen, non-executive directors, regulatory bodies and the HR community are now busy interpreting what this means for organisations in and outside of the financial sector. HR practitioners have an opportunity to be at the very sharp end of implementing some of these recommendations such as regular, (preferably externally facilitated) board reviews; changes to reward and remuneration practices and considerably more thorough and stringent selection and development processes for executive and non-executive directors.

These changes are targeted in the first instance at banks and other financial institutions but they will soon be extended into other sectors. The Financial Reporting Council (FRC), custodian of the Combined Code which promotes high standards of corporate governance in UK companies, has announced it proposes to adopt the recommendations of the *Walker Review* that it considers, after consultation, are appropriate to all listed companies, into a revised version of the Code due out next year.

How is board behaviour linked to the bottom line?

Sir David's research has concluded good governance depends on the abilities and experience of executives and non-executives, and it is behaviour deficiencies that have led to performance failures in the financial industry. Behavioural failures either took the form of excessive risk-taking or the inability to stand up to those seen to be taking disproportionate risks.

Behaviour is learnable, changing and dependant upon situational demands such as strategic context, social influence or the dynamic of groups. Behavioural demands (learnable components) and traits (intrinsic and innate components) of high-performing chairmen are extensive. They will include involving behaviours such as facilitation, empathy (consideration of and relating to others, followers and leaders) and coaching; strategic thinking behaviours such as concept formation and information search; inspirational behaviours such as influence, building confidence and communication; and performance-focused behaviours such as proactivity and continuous improvement. Traits might include physical vitality, stamina, eagerness to accept responsibility, need for achievement, courage, self-confidence, assertiveness and openness to new ideas. In other words for a board to function effectively it requires a chairman skilled in group relations, power dynamics, and the behaviours and processes required to maximise the intellectual capability of the group.

Behaviour evaluation is therefore crucial to not only establish that the composition of the board is effective, but also to put together the appropriate level of support and development for each member and its sub-committees. Using a robust evaluation process, such as the one we have developed and tested over the years based on our Behavioural Index Methodology, chairmen can identify with a high degree of accuracy the behavioural strengths and limitations of the board composition. This information can be used to develop a curriculum for inducting and developing board members which might include individual and group coaching; working with a group dynamics specialist to assist the chairman, board members and sub-committees through to understand and work with group process; identify roles group members play (natural leaders, group supporters and group de-railers); and to develop the necessary skills and behaviours to accomplish productive and cohesive groups.

The role of non-executive directors

The days when non-executive directors (NEDs) were appointed because of who they knew rather than because they matched a set of strict criteria have gone. The role, particularly in the financial sector, is now under strong scrutiny and the responsibilities that come with it are increasing. NEDs are now not only expected to have substantial industry expertise but also to get closer to the business by spending more time with it. They are also expected to have sufficient strength of character and skills to challenge the authority of the chairman, query decisions and be sufficiently innovative so as to make suitable recommendations.

For NEDs to meet all these criteria a clear commitment to their support and development is needed on the part of the company chairman and the board. This places demands on chairmen to ensure all board members have clearly defined role descriptions, that appointments are made against the role criteria and there are formal plans of development to fill gaps in knowledge, skills and behaviours.

Reaction to the *Review*?

Opinions of the *Walker Review* are mixed. Many organisations already carry out some form of board evaluation, they and their enlightened chairmen are engaged in the debate about what form best practice board evaluation should take. They welcome the opportunity to work on themselves and are keen to explore the latest research and practices in human selection and development. Others are less positive. Preliminary findings of a global risk management survey in 2009 by Cranfield School of Management and Moore, Carter & Associates indicate that while bankers accept blame for their role in the financial crisis they do not see the need for reform. Critics suggest Sir David's *Walker Review* is not radical enough and will be insufficient to create much needed separation of power in the board room.

We can reasonably expect that shareholders, who have been asked by Sir Davd to be more engaged and alert, are going to rise to the challenge and pay more attention to the evaluation process. The FRC is advocating for the chairman's statement in the annual report to include his views and recommendations on how the team fairs against the strategic challenges. This is definitely a step in the right direction.

Everyone agrees that behaviour cannot be regulated and rules-based reforms will increase innovation in circumventing the rules rather than improving corporate governance. While there are examples of boards who conduct regular thorough, externally facilitated reviews, professional board evaluation and continuous development of executive and non-executive directors is not yet common practice.

The *Walker Review* is a recipe book, not the meal itself. It is a lot bolder and more innovative than first meets the eye. But, the real work still has to follow. At the heart of the *Walker Review* is a multidisciplinary approach which combines board responsibility with the expertise of law, finance, psychology and social science. The coming together of such disciplines to consider corporate governance and the evolution of BOFI boards creates a mindset for organisational learning. It is the benefit of a learning mindset and a focus on collective responsibility that will improve governance – nothing less, nothing more. ■