Is the traditional board governance model passing its use-by date?

Cutting through the noise

Directors are all aware of the widespread dissatisfaction with governance performance. Over the past 18 months, there have been allegations of malfeasance by large and small financial institutions, mismanagement of misdemeanours on and off sporting fields (think cricket and rugby union), and large scale and endemic oversight failures in our religious institutions.

In response, commentators have argued for enhanced directors' skills and experience, deeper sector expertise, improved professionalism and dedication, greater time commitment, more intense focus on culture and codes of ethics, and a more equitable gender mix. And smart technology may also help; for example, AI and machine learning may 'lighten the load'.

As I listen to the debates, however, I find myself conflicted and unconvinced. Conflicted because, on the one hand, all the above factors matter greatly. Shareholders should not settle for anything less than competent and vigilant directors and (in my view) cognitive diversity. For many boards, just getting the basics of stewardship right, consistently, will be a significant step forward.

On the other hand, I'm unconvinced. I cannot help but feel like we are trying to solve the wrong problem, using tactics with which we fought the last war. I wonder whether the suggestions being made, while important, are enough? Are these proposals addressing the real problem? Are they getting to the underlying cause? Can they be sustainable solutions? Or are the escalating demands on some boards beyond the grasp of even seasoned directors? Is this a capacity and competency consideration, or is it a more fundamental structural question?

Navigating complexity in our operating environments

One cannot understand the demands on boards without considering the context. Running a large organisation is not straightforward: at the best of times it is complicated and increasingly complex. Further, as the rate and degree of change increases, businesses are also grappling with how to respond to growing volatility, uncertainty, complexity and ambiguity. By its very nature, however, you cannot engineer your way out of complexity with more structure, processes, etc. And throwing in more rules and controls isn't particularly helpful either. Traditional strategy, planning and control mechanisms and processes, seem poorly suited to what lies ahead.

'Contemporary' boards were built for a different era

Many corporations today, and not necessarily those that are large, are dealing with complex ecosystems (alliances and joint ventures), diverse investments, and project-based investments that may be capitalised off-balance sheet etc. Tracking these multiple moving parts is not practical under a traditional governance model.

Boards were built for a more sedate pace of decision-making, a narrower agenda, fewer expectations and scrutiny, less fluidity of capital, and an almost singular focus on shareholder returns across longer time horizons.

'Modern' boards are not well-equipped to deal with:

- the speed of decision-making and response cycles (can a board really wait 6-8 weeks between meetings to review data and key executive decisions?);
- the sheer volume of information required to understand the performance of a large modern corporation; and
- the range of additional responsibilities imposed on boards: custodians of culture, police of 'license to operate' matters, guardians of the brand, keepers of the sustainability/environment/community agendas etc. Shareholder primacy has become blurred.

How do we reframe the challenge for boards?

Key questions that today's boards face include: What do we need to do or change to be ready for a brave new world? Are we allocating capital in the most effective way? Do we have the right capabilities in place?

But there is a threshold issue: can a unitary board today still fulfil the purpose for which it was originally designed? Further, what *should be* the purpose of a board of the future? If we can answer that, we can develop a governance model (or models) that are 'fit-for-purpose'; that is, appropriate given the strategic intent and business model of a specific enterprise as well as the context in which it operates. As with the redesigning of any enterprise's operating model, this should encompass a consideration not only of the requisite processes and systems, but structural arrangements, ways of working and behaviours.

Where to from here?

'Fit-for-purpose' in terms of board design is no different to designing a building, car or furniture. There are always trade-offs to be made – it all depends on the organisation's needs and intent. Right now, a board is a 'one-size-fits-all' proposition.

I believe we are at an inflection point for governance where new, more modular constructs should be considered – so that companies, depending on their complexity, can mix and match components.

To illustrate the point, I offer up one idea solely as a provocation. I suggest commencing with Tricker's (1991) well-proven framework for board activities: conformance and performance. I would argue, however, that for more complex organisations (which are usually, but not always, larger organisations), conformance and performance need to be separated and a third distinct task recognised.

I call this third task *'transformance'*, which requires the ability to anticipate, embrace or navigate through disruptions, and propose changes to both the enterprise business model and the operating model. This is important as boards will increasingly be expected to operate as the navigator of complexity and the final adjudicator over ambiguous and complex choices facing the organisation.

Same same, but different

Why the proposed separation of focus? Each of these three board tasks requires different skill-sets, frames of reference and quite distinct thinking styles.

Conformance requires compliance and rule-based thinking (still critical thinking, but within parameters). It involves understanding and assessing risk and how to manage it judiciously.

Performance requires deep analytical skills, operational smarts, and an ability to determine how best to deploy capital and resources and leverage technology.

Transformance requires sensing skills, contrarian and divergent thinking, and not being psychologically wedded to an entrenched business or operating model.

The power of three

In order to fulfil these three distinct board tasks, I propose the creation of three sub (or working) boards.

Structure follows strategy. The planning horizons, mindsets and thinking styles of the members of each of these bodies are intentionally quite different. Each of these mandates and orientations is distinct but inter-connected. The 'power of three' lies in liberating these distinctive board member orientations and strengths in thinking, and then inter-linking them.

A ***Compliance sub-board*** should provide oversight – are policies, standards, rules and procedures appropriate and being followed adequately? Are we are keeping our people, customers and communities safe? Are we at risk of losing our license to operate (regulatory and social)? But also, are we understanding and embracing the right risks for the right reasons? (A watch dog function with a process/rules-based orientation).

A ***Performance sub-board*** should address ways to improve ROCE (return on capital employed) – how do we improve capital allocation and related decisions? How best do we balance protecting shareholders' funds versus growing them? (A guard dog function over capital).

A ***Transformance sub-board*** should sit alongside these, to guide management in framing and addressing hard-to-define, unstructured problems; that is, the complex decisions facing the enterprise. What are the shifts in customer behaviours, technological and social disruptions? How do we best live out our corporate purpose? This sub-board deals with 'emergence' and weak signals in their peripheral vision (A guide dog function).

Each sub-board should have a "hard core (of focus areas), but soft boundaries" – to cope with interwoven issues. Agendas would be different, and so too the cadence of meetings.

The power of three can be seen through the different perspectives that each sub-board can bring to bear. Take for example, the vexed question of culture. If you've sat on a board you will know that culture as an agenda item often suffers from limited airtime, limited hard data, limited 'unpacking' and a surplus of generalisations.

The value of having different vantage points is illustrated in how each sub-board may address culture. The *conformance sub-board* may ask: does our current culture place us at risk, reputationally or legally? The *performance sub-board* may ask: is our culture currently performing as we expect and supporting our brand promise? (including why, where and how?). The *transformance sub-board* may ask: where might our culture impede our ability to respond to the changes coming?

How to achieve joined-up decision-making

Linking this governance ecosystem should be a strong, muscled-up secretariat function. There should be at least one crossover member between each sub-board and each sub-board may also include external specialist advisors, in addition to the main board NEDs. The board chair should be attending all three sub-boards.

Note that it is not intended that a sub-board would bind the main board. Therefore, when the aggregated board comes together, it should be to review and make decisions – given the recommendations formulated by each sub-board – in order to preserve the unity of decision-making and accountability.

Rather than trying to persevere with the myth of an all-seeing, all-knowing, unitary board, each sub-board is fit for purpose – a slightly different purpose. Networked boards for a networked enterprise.

Sounds over the top right now? Maybe, but a volatile and uncertain world requires different responses via more diverse governance operating models: where stewardship is about incorporating different perspectives; where processing more and more detail doesn't always yield improved results, but pattern recognition is a valuable skill; where non-linear thinking fills the void that application of heuristics and rules of thumb can't.

Could this apply to your board? Admittedly some boards will not be feeling these external and internal pressures as much as others. But having a fit-for-purpose board operating model isn't a question only for the boards of major enterprises. Many smaller listed entities and mid-caps also deal with significant complexity and the weight of investor, regulator and societal expectations.

Remember, this is just one model, offered up to start the conversation. There are other options to consider and debate. The point is that before we, as a governance community, throw more time and effort at 'muscling up' our boards within the same standard structure, let's take the time to pause, frame the problem and ask the right questions.