

The challenge of the ‘representational board’

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One aspect of the recent Oil for Food events, which led to the Cole Commission of Inquiry but is unlikely to be a headline any time soon, is the composition of the board of AWB. The board includes directors appointed by two different classes of shareholder – Class A being the wheat growers who sell through the AWB, and Class B being the public; the chairman must come from amongst the Class A directors. Whether or not it is ultimately claimed or proven that the board structure had any bearing on the subject of the Inquiry, it is timely to visit the impact of representationally-composed boards can have on the delivery of effective governance for an organisation. (For convenience we will call them ‘representative’ boards.)

Boards such as AWB, where identified constituencies have special rights to control a specified number of board seats, are not as unusual as you might think, both among listed and unlisted entities.

In the listed company arena, there are a number of former ‘cooperatives’, similar to AWB, which maintained aspects of their representative boards when they converted to a listed company. (e.g. Warrnambool Cheese and Butter Factory, Namoi Cotton).

However, it is in the so called Third Sector (neither government nor business), the social economy that this style of board - formed by selecting representatives from the organisation's constituencies - is much more common. The constituencies will vary in nature depending on the body, but may be geographic, or activity based, such as in a mythical body of hunters and fishers, the NSW hunters, NSW fishers, Victorian hunters etc. Organisations such as industry and professional associations (e.g. AICD), charities, schools, clubs, community organisations, co-operatives, superannuation funds, credit unions, non-profit organizations generally, are commonly organised in this way. An obvious example is a university council, where it is common to find government appointed representatives together with members elected by academic staff, general staff, graduates, and some selected by the others!

(And lest you think this a trivial issue, consider that according to Dimensions of Australia's Third Sector, in 1996 – the most recent statistics available - there were between 500,000-700,000 third sector organizations, of which 320,000 of these have obtained a distinct legal identity via incorporation (that means there is a board!). In 1995/96, contribution to GDP by the overall third sector amounted to 3.3%. By 2000, the non-profits alone represented nearly 4%. Over the 1990s, the community services sector had grown rapidly as governments moved strongly to contracting out social services.)

Constructing boards in this fashion is superficially attractive. In theory, having a governing body representative of all interests seems likely to maximise the sense of ownership and

engagement by the organisation's stakeholders. In some cases, constitutions and vision statements convey the sentiment that boards have been constructed in this manner to protect the vision and values of the organisation from being overwhelmed by commercialism. (Note the *AFR* article of 25/03/2006 [ABC fury at Coonan board play](#): “Communications Minister Helen Coonan has provoked an uproar over the ABC by moving to abolish the position of staff-elected director, triggering fears she is clearing the way for greater commercialisation of the national broadcaster.”)

But the rationale for a representative board requires deeper analysis. In traditional corporate governance, ‘governance’ is about the balance of control amongst owners, management and other stakeholders with some reasonably clear delineation between the roles and interests of each. Boards are constructed from various constituencies most often in the Third Sector, where there are no ‘natural owners’ of the organisation. That is, no-one with the economic imperatives of seeking to earn a satisfactory rate of return on an investment. In the not-for-profit sector, when an organisation is structured as a Company, it is almost always as a Company Limited by Guarantee, the members of which are not ‘owners’ in that usual economic sense. We would argue that the role of the company members in that case is more of a ‘stewardship’ role, a role related to their interest, shared with their fellow members, in the organisation's underlying purpose.

One context in which this frequently produces confusion is where shareholders/members are cast as both customers and owners. In the listed sector, this form of board is most common amongst former cooperatives/mutuals where many of the shareholders are also engaged doing business with the company. Expecting shareholders/members to be able to separate out their distinct interests as customer & owner, is asking a lot, and such a structure risks a system where neither customer nor owner is adequately represented.

Often ‘Third Sector’ organisations try to apply a ‘democratic’ paradigm to the governance of the organisation. This may well suit some organisations – where their purpose is political in nature, such as advocacy, but in most cases, this approach simply clashes with the concept of the board as a cohesive unit under the Corporations Act. The Act treats the company board as a unitary body, rather like the political model of a cabinet, with cabinet solidarity, not in every respect obviously, but as a starting point – differing from the parliamentary representative government paradigm, which often functions on confrontational or political dynamics. The concept of a loyal opposition, integral to the Westminster system, has no relevance to a board of directors.

Of course, many Third Sector organisations already function in a challenging context (great demand for their services, complex qualitative objectives, or declining membership but those who remain are zealots in the cause, for example). Of course, these days, most organisations (not just non-profits) operate in quite complex stakeholder landscapes, as the James Hardie board learned the painful way. Whilst the board of any organisation, under law, must act in the best interests of the company, often its long-term sustainability depends on the maintenance of stakeholder confidence and/or support – and encouraging engagement through representation on the board, may help to do that.

We will return to the potential advantages, but it is unfortunately, more frequently that the negative aspects of these boards crowd out the positives. What are the typical failings of representative boards?

First and perhaps most important, is a lack of critical skills and experience, including in many cases, experience as directors. Removing the ability to consider composition of the board from an organisational perspective will inevitably produce gaps, and perhaps the most dangerous one of these is lack of an effective, independent chairman.

Second, and also quite common, is the tension between the directors' obligations to the Company and their commitments to at least some of the goals of their constituency. This often exhibits itself in conflicts between the need for a board to operate in confidence and demands from constituencies for reporting back. Conflict of interest management is critical here, as inevitably all directors appointed by a constituency have some degree of conflict. The distinction between delegates, those appointed to ascertain and act on the instructions of the constituency, and representatives, those appointed to an office to make up their own mind on issues in the interest of the organisation, is not well understood.

Third, and often as a direct result of these boards being quite large, are poor group dynamics – factionalism, caucusing, or defending prior positions (as opposed to productive discussion). Even messier are governing bodies which have split into two (or more) due to the large number of constituencies, resulting in the confusion of roles and responsibilities.

Fourth, is a common confusion around the respective accountabilities of board and management, as current customers/users often lack the ability to see the appropriate boundaries to their role. Simple enthusiasm for a cause can make representative Directors more likely to assume 'hands – on' roles and inevitably slide into 'micro-management'.

Finally, constituencies can fail to monitor the performance of their appointee, once the appointment has been made, resulting in reduced individual accountability.

Do all of those concerns mean that such boards are fatally flawed and only one step away from certain disaster? That the only possible board is a completely independent board, selected purely on the basis of skills and experience?

The answer is clearly no.

Firstly, representative boards can have a number of important strengths. Where directors are personally connected to the industry, cause, or activity they typically are enthusiastic and committed contributors. On boards where the representatives come from a range of constituencies, a healthy diversity of views and experience is certainly possible. Having Directors who are respected within their constituencies can provide credibility and ownership amongst stakeholders and such directors should be more likely to be able to predict whether management strategies and proposals will be acceptable to stakeholders.

In AWB's case, the constitution included a clause which required the board to endeavour to have a balance of skills, but it was not mandatory. Another clause re-iterated the Corporations Act requirement to act in the interest of the company as a whole.

There are a number of other strategies which can be employed to counter-balance the structurally generated weaknesses of representative boards.

Firstly, a strong strategic framework with clearly articulated targets and outcomes will provide the framework for decision-making, without which the risk of falling back on special interests emerges.

Secondly, setting out clear board operating protocols – by that we mean not just the standard 'role of the board vs. management, but also those informal, usually unspoken, rules of engagement about 'how we do things here' that make a board work or otherwise. In this category, we would put issues around solidarity, confidentiality, the authority of the chair. Also included in this should be conscious strategies to improve group dynamics.

Thirdly, extensive director induction to accelerate effectiveness, whether this means industry training or general director education.

Finally, accountability mechanisms should be implemented to ensure well meaning but under-performing directors either lift their game and/or are managed off; formal, independent board and individual director reviews play a critical role here.

In a recent AICD submission to the "Inquiry into Rural and Regional Women's Representation), in February 2006, the AICD stated that ".....the best composition of a board (and one that leads to diversity) results from a thorough, honest and regular review of the needs of the company and evaluation of the board's performance."

Whatever process is used for determining the composition of the board, the objective for any governance framework is the same - to produce stable and effective leadership which underpins the achievement of the organization's objectives. It must provide for stewardship of the organisation's vision and values over long periods, whilst sustaining the organisation through shifting economic challenges. It must ensure that the organisation fulfils not only its legal obligations but also its broader civic responsibility.

There is no inherent reason why a representative board cannot provide such leadership. In fact, there is no one governance model that magically delivers this sort of leadership in any and all contexts. All systems have their weaknesses. The trick is to be aware of your problems, acknowledge them and address them.