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Boardroom

REVIEW, ANALYSIS, AND GUIDANCE FOR CORPORATE DIRECTORS

Trust is Central to Governance Process

AN INTERVIEW WITH ROGER MARTIN

Roger Martin is Dean of the Rotman School of Management at the University of Toronto. He has spent the majority of his career as a management consultant with some of the world's top corporations as clients. He is a corporate director on a number of boards and also served as a member of the Saucier Committee which recently produced its interim report on corporate governance. *Boardroom* posed a number of questions to Mr. Martin in a recent interview.

Boardroom: Canadian directors, contrary to the trend in other countries, have consistently rejected the kind of education strongly advocated in the Saucier Report?

Martin: I believe there are two main reasons. First, I am not sure that the educational institutions have demonstrated they have a credible program. There is not enough available compelling product. Second, the people who are directors - highly accomplished people - generally do not have a mind set that says they are in need of a lot of education. "I don't need to learn how to be a director."

How can we overcome this impasse? It depends if there is a regulatory will to make education mandatory. If there is enough belief, then it is up to the regulators to say you have to. Then it is up to the providers to produce a compelling product so that directors won't query the regulation and actually learn something interesting: "How this can be helpful to me in my job".

Boardroom: Will a more prescriptive approach work, or should there be some kind of incentive?

Martin: It seems to me that currently director education is a little too much of the finger-wagging type. It's like ethics teaching in business schools - it hasn't taken off. It's tremendously important, but ethics is too much like saying: "You should be doing this." What kind of practical things can directors be doing to be a better director? We should consider what are the fundamental structural dilemmas and problems that get created in governance and what directors have to do to overcome those? We have to get to the level of a systematic understanding of the flaws and then the answers. We often talk about the generalities of good governance in an unreal world. It doesn't take into account reality.

Boardroom: Your paper on "Board Governance and the Responsibility Virus" identifies why "it is an increasingly daunting task for a director to question a CEO on management initiatives." How can a board maintain an appropriate oversight on a strong-minded CEO?

Martin: This is the tough challenge. Why is it daunting - it is simply the information asymmetry. Management will always have way more information than the board will. No amount of board briefing material will overcome this. It is always going to be the case. The CEO has lots of information,

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Institute Celebrates 21st Birthday

EDITORIAL

The recent annual general meeting of the Institute of Corporate Directors in June marked its 21st birthday. Founded in June, 1980 as an offshoot of the UK Institute of Directors which now has approaching 55,000 members worldwide, the Canadian Institute became an autonomous affiliate in the late 1980s. The Institute has a mandate to represent the interests of individual directors and those that interface at board level, and promote sound corporate governance.

The fact that the Institute has survived 21 years and currently has approaching 400 members is an achievement in itself. For some reason, corporate governance in Canada and the US, despite its attention by stock exchanges and regulators, has not gained the appeal that it has in other Commonwealth countries. Australia has some 13,000 members, New Zealand over 3,000. Perhaps this is due, at least in part, to the different board make-up prevalent in the United States and Canada?

In Canada and the US it is comparatively rare for more than one or two of the most senior employee executives, such as the CEO and COO, being invited to join the board. In the UK, it is quite common for the majority of the board to consist of senior managers with relatively few outside, independent, members. In fact, the UK IOD has embarked on a crusade to try and encourage smaller listed companies to have at least one director who is independent of management, something that would not be acceptable by shareholders here.

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the board some. Much of the information is what we call specific information which resides in the head of the CEO by dint of what he does every day. This is hard to transfer. If the CEO wants to obscure information such as "how hard will it be to accomplish budget goals?" it could be well-nigh impossible for the board to discern. However, if there wasn't this information asymmetry, and the board knew as much as the CEO, then it should fire him!

This takes us to the point where the CEO can use this advantage to get what he wants. If it's different to what the board wants, you have a problem. This is where the question of trust comes in. Why it is so important for the board to be non-arbitrary and non-dogmatic. Because the CEO, having this information advantage lives in fear of proposing something that he believes is in the company's best interests, and the board saying "No, we're in charge, pursue this course of action and get back to work!" If the CEO is also chairman he has significant added power to run the board agenda. It also supports why there is a tendency for CEOs to keep information to themselves, to buttress an argument or shape the agenda so as to produce the result they want.

Boardroom: The Saucier Report places emphasis on risk and the identification and management of it, and that the responsibility to ensure the risk is addressed rests firmly with the board?

Martin: I believe that there will be an attempt to do try and do so, but essentially it will have no impact whatsoever. The thrust is part of the dream that boards can figure things out. It's just an illusion that the board can say we understand exactly what the risks are in this company and are going to monitor them. The dominant risk by far is the strategic risk. Is your current business value proposition sound or not? This is where the CEO has the huge information asymmetry advantage over the directors.

Boardroom: You are on record as stating that "trust is incredibly important and central to the governance process, otherwise the system seizes up?"

Martin: What will motivate the CEO to share with the board his greatest concerns about the true risks, the strategic risks facing the company and the true nature of the decisions necessary? The answer is not to be unilateral and arbitrary. The board and the CEO are going to discuss this together and come to an agreement. He will not give the board the tools to make decisions against him. It's against human nature. If he's faced with a non-recourse situation, the CEO will withhold information. Basically, the CEO considers the board as a useful sounding board: "I can come to them with my toughest problems, lay it on the line, say I'm not quite sure and would like your thoughts and ideas." That's what I mean by trust. It's not having the board say, if you're not decided, we'll decide for you.

I think it's the chairman's job - and I strongly support the separation of roles - to run the board so as to have a culture and an atmosphere of trust. This is the only way that board chairmen can overcome this information asymmetry to the extent that board governance is not a farce.

Boardroom: How will good behavioural dynamics improve *how* the board performs?

Martin: If you have the trust that I have described, then you can have the dialogue in which the important issues that the board should care about, the big strategic risks, will actually be raised in a way that good solutions can come forward. But then there's the question of talent. If the board members have little talent or expertise they can bring to bear that can extend that of the CEO; if they don't have the background, or they're not good decision makers, then it doesn't matter if you have trust, you'll have poor decisions, or situations where you could flip a coin. Typically, if you go out and select a bunch of impressive board members with qualifications and experience and you engender an attitude of mistrust, they're rendered virtually useless. On the other hand, if you build trust and don't have comparable expertise, you still have a problem.

The good news is that if you can build trust, it will be more fun. There's a win-win situation here, but it takes enormous skill to forge the relationship.

In a future article we shall discuss Roger Martin's views on aligning board competence with trust and also learn his views on a director rating system.