Questions directors should ask before ASIC does

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Beyond governance to ICEbreaking

With the Roy Morgan Consumer Confidence Rating for January at 126, an all-time January high, the big question for company boards today is how to maximise the opportunities this buoyancy presents.

Over the last year, Roy Morgan Research has interviewed more than 1000 company directors to establish their views on the economy, government and social issues with particular emphasis on asking high profile, successful directors about the collapse of former high profile companies.

Directors clearly see that the role of the board should be directed towards growth, setting future strategies and ensuring sustainability and profitability. However, the majority say that in practice, "most time and effort is placed on ensuring the business is sound financially, and on compliance issues".

There is little doubt that the next five years will be no less turbulent than the last five, which were characterised by the technology and venture capital-led dot.com era, the awareness and spread of globalisation, the clash of civilisations, with terrorism, fear and security issues taking the foreground.

Today, the 51-country Roy Morgan/Gallup International survey indicates that most people in most countries feel less safe than they did ten years ago and anticipate more global unrest in the future.

Amidst the turbulence and unrest, it is back to business - but in a different world. Consumer confidence is high, and the world is in the middle of a new era, defined by globalisation, technology and communication, elimination of traditional boundaries and a strategic focus on the global market place.

Globalisation means efficient supply is increasingly taking precedence over geographic proximity. Regardless of whether the Free Trade Agreement between Australia and the United States proceeds, global alignments will impact on all industries.

Technology has increased the precision and speed with which we do almost everything - from building a car or a highway to the speed with which new technology itself can be created. Technology has also increased both the complexity of information and the speed with which it can be transferred and processed.

This is no time to stand still - or to do more of the same. The combined impact of globalisation and communications/technology has weakened the boundaries that separated industries. Many transformations have emerged from this: a credit card is now in many ways doing what a bank does; a gas or electricity company that installs a direct line to its customers is potentially in the business of telephony; a manufacturer plus the internet can be a retailer. The new era creates opportunities and threats in abundance.

Andrew Groves mentions the concept of "strategic inflection points" in his book *Only the Paranoid Survive*. He points out a time when new opportunities and threats mean the business paradigm is changing. Managed wrongly, a strategic inflection point can mean the end of the game. Managed right, it can turn into a powerful force. The high consumer confidence rating means now is a great time to grasp the opportunity and manage it right.

The ASX and Standards Australia have articulated their protocols for good corporate governance and the first round of annual reporting since the introduction of the new governance guidelines is over.

However, the real debate is more fundamental and rooted in society's needs, wants and expectations. It's about values - society's values, board values, individual company directors' values, corporate values, and how these sets of priorities come together. It is critical now that company boards get back to the real job - directing.

This means not just watching what the captain does, but steering the ship - from the mundane to the meaningful. It's about going beyond governance. It's about transformation, what futures consultant Colin Benjamin, in his Mt Eliza Business School lectures, calls "ICEbreaking" - innovation, creativity, and entrepreneurship.

For many directors this is a fearful thought that raises many questions. What about the risk associated with transformation? Is there time for the board to prioritise and focus on transformation? Is it appropriate given the respective roles of the board and management? Does the board have the necessary skills and knowhow?

Roy Morgan research has found Australian company directors to be concerned that the responsibility to achieve good growth and good returns is leading to acceptance of higher-risk ventures. They believe that the large corporate governance failures arose from pressures to get bigger too quickly, without adequate information systems or adequate measures of accountability.

A company director may well ask, isn't the transformation path littered with failures? What about AOL Time Warner, OneTel, Parmalat and countless small businesses that "transformed" from successful, albeit traditional businesses into internet businesses, and lost everything? And while there are success stories like WPP, GE and, locally, Harvey Norman and Bunnings, isn't it more appropriate that the board of directors plays a conservative review role and focuses on preventing another disaster?

While this might be a comforting

thought, the answer must be a resounding no. In the real world, standing still means going backwards. And as we shall see, management, charged with efficient implementation of the board's strategy for the company, is inherently conservative and ill-equipped to drive transformation. Moreover, the perspective and responsibility of company directors is vastly and qualitatively different, more expansive, and inherently more complex than that of management.

Directors must add value to shareholders and look out for the interests of other stakeholders - customers, government, statutory authorities, employees, suppliers, partners, the broader industry, community groups and society at large. Directors must identify the difference between shareholder and stakeholder interest.

Shareholders get the residual of what stakeholders get (i.e. profit plus goodwill). Management looks after the profit, and therefore, shareholder value. Directors represent, or look out for, the interests of all stakeholders in the success of the business - and look for the opportunities those relationships bring.

Directors must be aware of emerging markets and trends. The board must create the critical channels by which relevant information of all kinds can reach them. Non-executive directors need to be a company's eyes and ears, not just a voice. Directors must use their experience of life and the community to inform the board's thinking.

The board's decision and review process must recognise all these diverse and complex inputs and deal adequately with the complexity generated. A simple one-dimensional approach is not adequate.

We go further than that and argue directors must build "formal alertness systems" - they cannot afford to hear only what they are being told. Look at the National Australia Bank rogue traders debacle - where was the alertness system when all that was taking place? While enjoying the impact on the profitability of the company, did no alarm bells ring? Did no-one wonder how these people could be making so much money? But even if some were aware, and alerted, these are all informal alertness devices and fundamentally different from a formal alertness system.

The board must create and encourage an appropriate environment and culture of change. Every day the business must be looking for new opportunities at every level, from better ways of doing things to efficiencies to be gained, as well as the bigger ventures usually associated with the concept of transformation. Incidentally, the spectacular failures mentioned earlier were of this kind - failed entrepreneurial ventures.

A board of review is a critical mechanism in an ICEbreaking culture. It provides the forum for ideas and proposals to be recognised, valued and reviewed and is simultaneously designed to stop entrepreneurial failure.

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So what is transformation? And what is ICEbreaking? If we think of innovation as exploiting marginal opportunities to make better use of a resource, creativity as establishing new ideas and entrepreneurship as new businesses, then ICEbreaking is a combination of all three.

It is the differences that make a difference and the board must actively engage with these differences. For creativity, people need to explore differences, not just novelty and not just extensions of current areas of activity and safety. Recognising and valuing differences is crucial.

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ICEbreaking explained

Innovation: Marginal opportunities to make better use of a resource (good practice)

Creativity: Establishing new inventions, new ways of doing things or new applications of existing resources to get change (good process)

Entrepreneurship: New businesses, capturing the opportunities, getting the price and the prizes

Management is inherently focused on seeking efficiencies through consistency. Therefore it seeks out and aims to increase consistencies. So the board must focus on the differences.

Management must be encouraged to bring the differences to the board. Note that the focus on difference will also inform the formal alertness system - an inexplicable difference, even a financially positive one, warrants further exploration.

The formal alertness system must be part of the ICEbreaking system, lest it become a firewall, keeping all differences locked out; or worse, a system from which management feels the need to protect itself, in order to hide the differences. For instance, complex ratios and metrics, as previously discussed in *The New Investor* (November 2003), can hide many critical differences.

To generate the possibility of creating more than budget it is inadequate to have more of the same (that is the basis of the budget). What is required is more and better. The board must look beyond what is, or what has been, to what can be.

For a company board to take full advantage of today's record consumer confidence, it will need to be comprised of three different types of people. First, successful managers who bring experience so that the company doesn't need to learn from its own errors. Second, those who question and challenge conventional viewpoints and ask: "Is there an alternative? Why are we not doing what a competitor or a company in another country or industry is doing?" These directors may be champions for change, with a real eye for the future, who ask questions like: "Are we still playing with yesterday? What are we not seeing? What's the new dimension?"

Third, a board needs those who capture the opportunities and who go out and get the businesses, make the mergers and the takeovers happen and attract the capital.

Transformation cannot be delegated to management; it is the role of the board just as clearly as governance is. Only when accountability, governance, transformation and ICEbreaking come together at board level can accountable transformation create growth in value. ■