

Transforming Your Governance Practices

*Sport Leadership Conference
October 13th, 2007*

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This morning's session is designed to address...

- *The Why of Governance:* theories, models, principles and trends
- *The How of Governance:* leading governance practices, principal - board – agent (management) roles and relationships,
- *What Models are best for your organization:* an exploration of emerging issues in governance and how they relate to your situation

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Boards of Directors ...

are responsible
for the
governance
of their
firms

Cadbury Report (UK, 1992)

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Corporate Governance Is ...

... the system
by which organizations
are directed
and controlled.

Cadbury Committee Report (UK 1992)

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Governance is how you answer

the key question in economics

How do we allocate *scarce resources*
to the most *effective uses*?

Agency Theory

Principals

Principals and Agents

- **Principals** are the people:
 - Who created the organization
 - Who have a purpose for the organization: needs that it can meet
 - Who contribute (invest or give) resources / capital

Agency Theory

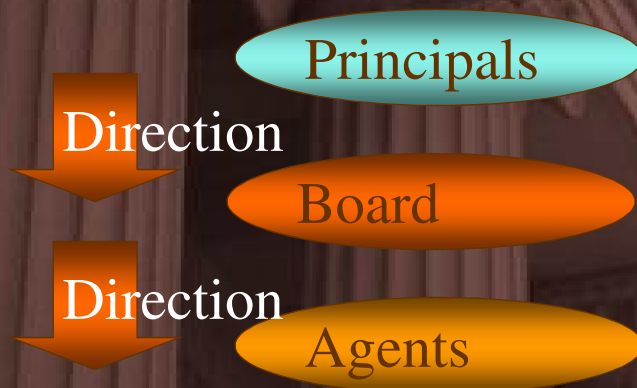
Principals

Agents

Principals and Agents

- **Agents** are the people:
 - Who undertake the organization's activities, to meet the principals' needs
 - Who employ (use) resources / capital

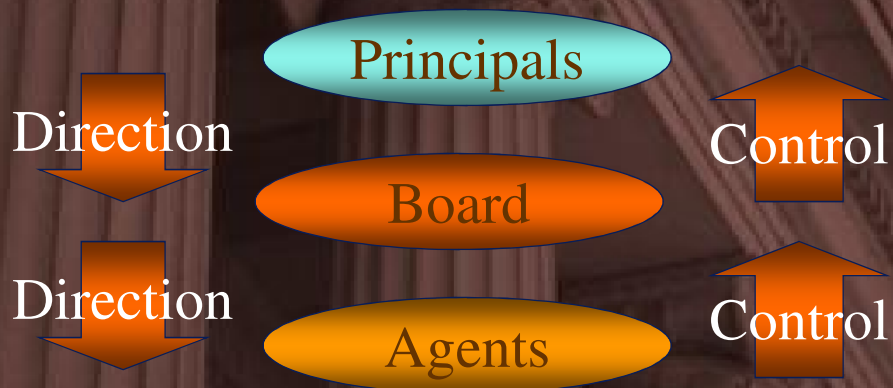
Agency Theory



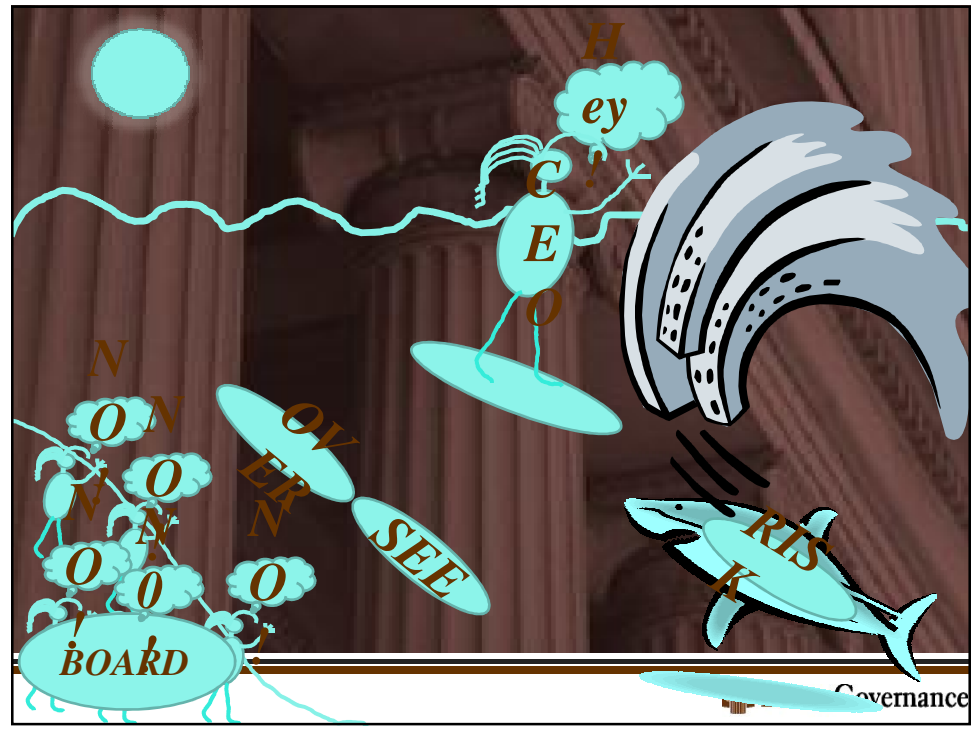
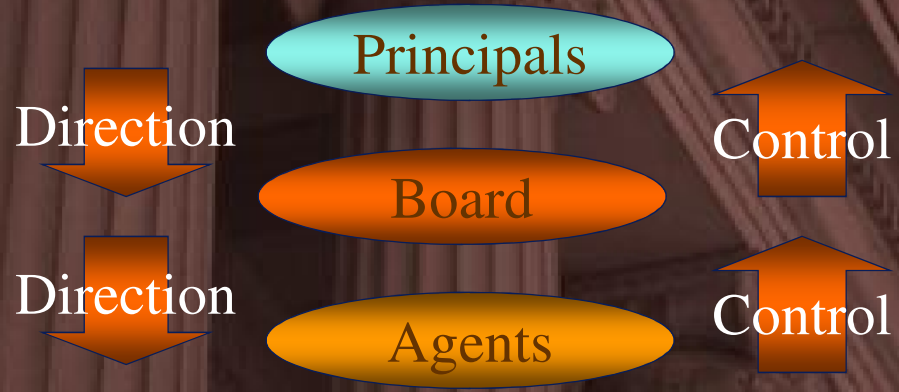
Direction

- Direction is being the “rudder” of the corporation
- This matches the unmet needs of the principals (purposes) with the best ideas of the agents (uses)
- Strategic plan is primary tool
- Risk assessment, delegation of authorities, and budget are other key tools

Agency Theory



“Governance” Board: Agency Theory



Control

- Control is “the degree of confidence the board has that the corporation is going in the direction approved”
- This follows the resources of the principals as they are used by the agents, and accounts for their use
- Financial statements are the primary tool
- Also entire board info package

Governance Board (Agency Theory)

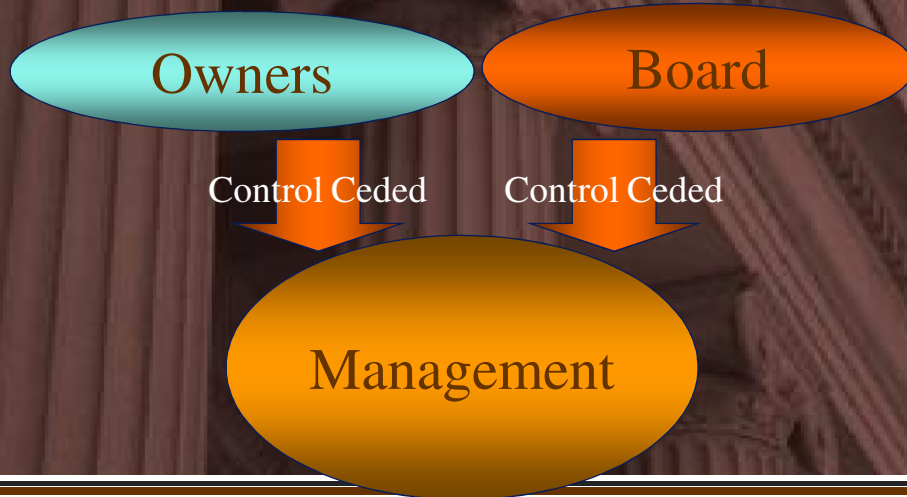
Strengths:

- Independent intermediation in best interests of the corporation

Weaknesses:

- Requires two key qualities in the board:
- Competence, and
- Character

“Advisory” Board: Management Theory



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Advisory Board (Management Theory)

Strengths:

- One boss, one vision, one message:
- Flexibility
- Immediacy

Weaknesses:

- Dependence on one person
- Circularity in accountability:
 - Holding “imperial” CEO accountable?

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“Collaborative” Board: Stewardship Theory



Collaborative Board: (Stewardship Theory)

Strengths:

- Unified team and tone at the top
- Board expertise assists CEO

Weaknesses:

- Board drawn into management: lose independence
- Circularity in accountability:
- Holding CEO accountable

“Intervening” Board: Democratic Theory

Owners: democratically elect
representative directors from among their number

"Lay" Board: key
competency is membership
as owner

Organization

Intervening Board: (Democratic Theory)

Strengths:

- Levers of direction and control in hands of those who:
- Created corporation for their purposes/needs
- Have most at risk

Weaknesses:

- Sponsorship scandal: acting in interests of shareholder(s) vs corporation
- Independence and Competence hit-and-miss

“Operating” Board: Stakeholder Theory



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Operating Board: (Stakeholder Theory)

Strengths:

- Most inclusive:
- All those with a legitimate stake have both voice and vote (vs. stakeholder advisory committees which have voice but no vote)

Weaknesses:

- Inherent conflicts of interest vs acting in best interests of corporation
 - Slow, difficult decision-making
- Shifting sands to management
- Focus on direction not control (European binary boards)

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Your First Choice

- How actively engaged should the board be in the corporation?
There is a spectrum:
- Passive ... active ... over-active =
lapdog ... watchdog ... pitbull =
rubber stamp ... micromanaging
- Who holds levers of governance?
- In whose interests does board act?

Transforming Your Governance Practices

- 0 **Very Passive (“Advisory” Board)**
1 (management agenda, packages, reports, "yes" votes)
- 2 **Some oversight, little strategy (“Collaborative” Board)**
3 (fewer, shorter board meetings; few committees)
4
- 5 **Moderate: clear line (“Governance” Board)**
6 (5-6 meetings; 3 committees; liaison with advisors)
7
- 8 **Active Beyond Governance (“Intervening” Board)**
9 (12 meetings; long; thick packages; 5+ committees)
- 10 **Very Active: micro-managing (“Operating” Board)**

Indicators of 0, 1, 2 Board

- Management sets board and committee meetings, agendas, times, packages (late), items “walked in”
- CEO stronger (competence / character) than board
- Highly competitive markets or industry
- Entrepreneurial firm, early in life cycle
- Small board, quarterly meetings, under 3 hours, few board committees
- Board never votes no, no tough questions

In What Direction Should You Move?

0 *Management theory*

1 Becoming more active in strategy ↓

2 ✓ SOX/CSA new standards

3 ✓ More Committees, more meetings, info

4 ✓ Specific competencies, skills on board

5 *Agency theory*

6

7

8

9

10

Indicators of 8, 9, 10 Board

- Board meets monthly, uses 4+ committees, undertakes significant work in key areas
- Board stronger (competence / character) than CEO
- Not for profit, public or co-op sector
- Large board, long meetings (1 day +)
- Executive Committee vets agenda items, decides on presentations, recommendations
- Board/committee work beyond strategy and control to HR, marketing, facilities, IT, etc.

In What Direction Should You Move?

0

1

2

3

4

5 *Agency theory*

6 ✓ Fewer committees, meetings; shorter

7 ✓ Smaller board, no executive committee

8 ✓ Info/time focused on results, risk, policy

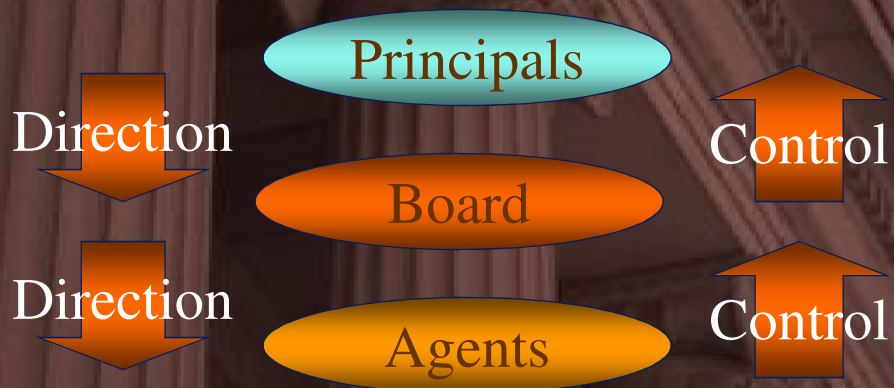
9 Becoming less active in operations ↑

10 *Stakeholder & Democratic theories*

Transforming Your Governance Practices

- 0 To engage the Board MORE ...
- 1 Agency models: SOx, Committees, Control
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9 To engage the Board LESS ...
- 10 Results models: Carver Policy, Turnbull

“Governance” Board: Agency Theory



Direction: Core Governance Roles

- Leader:
 - Active input into the Strategic Plan and review/approval
 - Active involvement in board, committee renewal and CEO succession
- Steward:
 - Ensure resources are allocated wisely: risk management, budgets, performance
 - Delegation of authorities – board, committees, CEO, management

Control: Core Governance Roles

- Monitor:
 - Using the right measures of success (performance) and getting the right level of information
 - A robust audit and control system
 - CEO Evaluation and Compensation
 - Board, Committees Evaluation
- Reporter:
 - Continuous and periodic disclosure and accountability to principals (public)

Trends: C-SOx Reforms

- 3 Key words = “independence” + “competence” + “diligence”
- 3 Core areas = Financial oversight + CEO oversight + Board oversight
- 3 “Final” pieces = ICFR + CD&A + IFRS

Trends: Committee Structure

Patrick O'Callaghan & Associates

	1996	2004	2007
Executive	36%	14%	9%
Governance	58%	89%	93%
Environment	25%	26%	32%

Your Choice

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Questions re: your organization:

- (1) How active is your board now?
- (2) How active should your board be?
- (3) How clearly delineated are responsibilities (delegation of authority)
- (4) How well are diverse stakeholder interests reflected? Listened to? Incorporated in plan? Measured?
- (5) What direction? Theory/model?

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Implications for our Organization, our Board, our self?

Let's Talk



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Board Evaluation

Financial Literacy

Risk Management

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20 Questions series

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Best Practices and Self-Assessment

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