

M O R R O W  
S O D A L I

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# Governance Newsletter

## Holding boards accountable

Shareholders and proxy advisors are becoming more vocal, engaging with ASX-listed companies on the suitability of non-executive directors. A growing proportion are critiquing the performance and accountability of directors, particularly where there are alleged breaches of conduct or the company is underperforming.

The responsibilities of non-executive directors are both varied and increasing, so it's difficult for investors to establish a standardised approach to evaluating board performance. Non-executive directors classified as 'independent' may not be *socially* independent from their colleagues, which may impact their ability to perform their duties without prejudice<sup>1</sup>. Shareholders continue to lack clear insight into the inner workings of boardroom dynamics, hence their characterisation as 'black boxes'. More than ever, the investment community and broader corporate governance stakeholders are demanding a deeper understanding of the factors that influence board interactions and decision making. Consequently, strong disclosure around board performance, skills, experience and succession planning initiatives is critical.

Academic research recognises the importance of reciprocation and social influence and the extent to which self-interest can have negative effects. Many directors use ingratiation, through flattery and opinion conformity, to manipulate outcomes<sup>5</sup>. Directors may feel indebted to whoever offered them their position, and obliged to follow their lead<sup>2</sup>. This clouded judgement and lack of independent thought is among many reasons why shareholders are justified in seeking additional assurances around board performance candidate suitability.

## Meaningful board skills matrix disclosure

The Board Skills Matrix (BSM) has become an integral feature of a company's corporate governance statement<sup>3</sup>. Over a three-year period, Morrow Sodali has tracked a noticeable increase and improvement in S&P/ASX 200 BSM disclosure:

- In 2017, 21 companies provided enhanced detail on director skills and experience and insight into how the board seeks to align with strategic company objectives and shareholder wealth, up from 9 in 2015.
- Seven companies disclosed director-specific information, highlighting the skills and expertise of their respective non-executive directors.

However, just under half of the companies' disclosure was either poor or non-existent<sup>4</sup>.

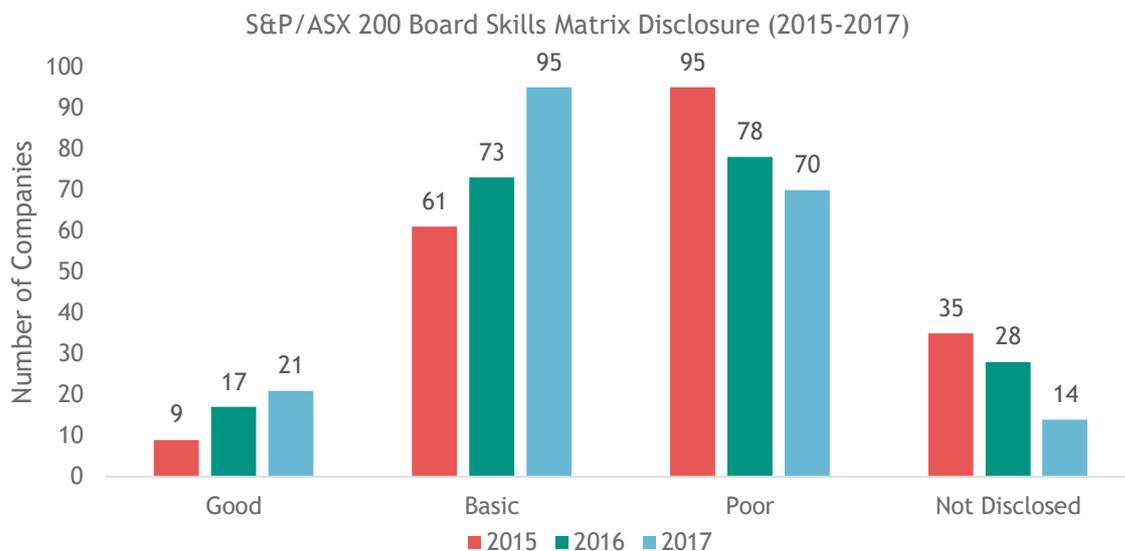
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<sup>1</sup> Ma & Khanna (2016)

<sup>2</sup> Tang, Du & Hou (2013)

<sup>3</sup> Under the 3<sup>rd</sup> edition of the ASX Corporate Governance Council's Recommendation 2.2, all listed companies should "have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership." A BSM provides shareholders and governance stakeholders an opportunity to evaluate the composition of a board and highlight the potential gaps and opportunities that would improve a board's cohesiveness.

<sup>4</sup> Source: Morrow Sodali's 2017 [AGM Season Review](#)



### What can companies do?

Morrow Sodali encourages companies to disclose whether an external board performance evaluation has been undertaken, in line with ASX recommendations<sup>5</sup>, as well as any insights and resulting governance changes.

Bluntly stated, ‘lets-be-nice’ or ‘fill-out-the-form’ board evaluations are no longer sufficiently meaningful for shareholders<sup>6</sup>. According to a global survey of over 2,300 companies, 70% regularly use self-assessment as a tool for board evaluations. The assessments are overly optimistic, with 88% of directors rating the overall board performance 4 out of 5<sup>7</sup>, affirming the need for independent consultation<sup>7</sup>.

An independent board evaluation generally includes open and candid responses on topics such as:

- the structure, size and composition of the board;
- how well the board functions together;
- their perspective on the independence of fellow directors; and
- committee-specific questions.

The result provides a board with a clear and honest view of non-executive directors’ opinions. This can be aggregated into an action plan to improve the functionality of the board and support future succession planning initiatives.

### How our expert advice can help

Morrow Sodali offers deep knowledge and expertise of both ESG reporting and the unique perspectives of institutional investors and proxy advisors. We provide a range of tailored services to help companies enhance their disclosures including board composition and skills matrix narrative. We welcome your call to discuss how we can help and provide further information and insights.

<sup>5</sup> The 4th edition Consultation Draft of the ASX Corporate Governance Council’s Recommendation 1.6 states, “a board should consider periodically using external facilitators to conduct its performance reviews.”

<sup>6</sup> Szabo (2015)

<sup>7</sup> Cheng, Groysberg, Healy & Vijayaraghavan (2017)

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