

# "Across the Board"



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BUSINESS

## Outlasting your welcome.

By Alan Cameron, Chairman, Cameron Ralph Pty Ltd, a consultancy which assists boards provide effective leadership, improve their performance and build positive reputations.

When is enough, enough? At what point should directors hang up their boots, or, if not wanting to dismount from the unruly horse that some perceive the modern public company board to be, seek to find another steed? Those questions don't seem to be going away, or getting better. I shall re-visit the received wisdom, note some complications, and seek to find some parallels with other spheres, such as politics!

Let's start with the ASX Guidelines. In the context of recommending that a majority of the board should be independent, they note that the tenure of each director is important to an assessment of independence, and that the period in office of each director should be disclosed. But they stop short of including in the definition of independence setting any period in office which would lead to loss of independence; their note reads as follows "The UK Higgs Report nominates 10 years in relation to director tenure considerations, but has not yet (sic) been adopted in the UK."

Curious then that my copy of the Higgs Report actually says that non executive directors should normally be expected to serve two, three year terms (which is **6 years** by my reckoning); that there will be occasions where value will be added by a non executive serving for longer but this would be the exception, and reasons should be given; and that after **nine** years annual re-election is appropriate. I should say that there is nothing other than assertion to back the propositions for 6 or 9 years – no tiresome evidence to deal with such as the relative

performance, or even conformance of companies according to the terms in office of the directors. The only argument seems to be in the following "Beyond six years the possible benefits of a fresh appointee need more careful consideration, although there will be cases where the particular director continues to justify their place ... over a full nine year period."

The *evidence* relates instead to how long directors actually serve: from the results of the research that the current population of non-executive directors in the UK have been in their roles for an average of 4.6 years is drawn the conclusion that on average a non-executive director spends "significantly longer" in a post. How much longer is presumably guessed at but not stated. In view of the lack of evidence, one can only conclude that Higgs' weak preference for 6 or 9 years is based almost entirely on a gut feel as to when fresh thinking might be needed.

So the *ten* years does not come from the Higgs Report. It does not come from the Combined Code, 2003, either, since that merely states that the board should say why directors who have served more than 9 years are still regarded as independent; that any term beyond 6 years should be subject to "particularly rigorous" review; and those serving longer than 9 years should be subject to annual re-election.

Higgs received submissions to the effect that there was a lengthy learning curve for a non-executive director, so that a long tenure is in the company's interests. He responded that everything possible should be done to accelerate the learning curve, by systematic and thorough due diligence and induction processes, followed up by training and professional development as necessary. But my own view is that the common belief that it usually takes 3 years to get on top of the issues of the business and the boardroom, followed

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by another 3 years of really useful contributions of both a strategic and monitoring kind, and then another period of around 3 years in which one is expected to mentor and guide the newer directors (and find a successor), is close to the mark. Not a rule, but a starting point for a conversation about what role the director is presently playing.

Some are true whiz kids (or the business is straightforward, or whatever), and in those cases the director may be able to get on top of the issues in one year rather than three. Doing that in other cases, with directors perhaps newer to the role or companies in complex businesses with complex regulation or products to contend with, may take longer. The idea that directors must justify their contribution in a "particularly rigorous" way, just when they are getting on top of the market issues confronting the company, and the subtle relationships around the board table, just as a new CEO is to be appointed for example, seems bizarre to me. They should be justifying their contribution all the time, and if some rule or precept is being advanced to move them on or annoy or embarrass them by declaring them suddenly to be no longer independent, all one has done by encouraging premature exit, is to strengthen the power of management, not improve the lot of shareholders.

But the idea of a limit also makes no sense if the circumstances of the company have changed dramatically. For example the company may have merged with another, or expanded its operations into new markets - and the medium to long term director is not only the best monitor on that strategy and should be able to take some credit, but ought to stick around to be accountable for it as well! And what if the director is the best person to succeed as chair - surely they should not be subject to these "rules"? Higgs of course, put chairmen in a different category; he saw them as necessarily not independent because of the strong link they

must have with the CEO - hence the concept of the lead independent director. His view was, no standard term for tenure of chairmen, but three year terms, renewable "where appropriate".

I have observed the creeping spread of the tenure limit phenomenon in other arenas. The federal government for example has effectively required the states to legislate for the governing bodies of all universities, in accordance with the National Governance Protocols For Higher Education Providers, which include the following:

To provide for the introduction of new members consistent with maintaining continuity and experience, members' terms must generally overlap and governing bodies must establish the maximum period to be served. This should not generally exceed 12 years unless otherwise specifically agreed by the majority of the governing body.

Those final words are somewhat reminiscent, of course, of the pre nuptial debate which erupted last year around CCA, when CCA was forced to retreat from their director agreements under which directors would resign if a majority of their colleagues thought they should. This provision for universities gives the majority of the council the opportunity to remove the gadfly, even if, as is often the case at universities, the gadfly has been elected and re-elected by a specific constituency which continues to want their interests represented by that person. As for the 12 years "limit", I understand that in Victoria, local legislation makes the time limit a total of 6 years, even for chancellors (the equivalent of chairmen) - that strikes me as very odd.

Which brings us to the political dimension. There are major and minor polities in which

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there are set limits on terms – among the majors, the USA and Japan spring to mind, even though the performance reviews, called general elections, are undoubtedly "particularly rigorous". Those limits usually apply to presidents and prime ministers, the CEOs, and not to the cabinet ministers, nor MPs – the latter being the closest to non executive directors, I suppose. Arguing by analogy from that arena involving executive roles and the inevitability of contested elections, to non executive directorships is simply not sensible. The latter are usually discussed and decided privately by nominations committees, and lead to service as part of a team which in turn operates, for good commercial reasons, behind closed doors.

The conclusion is suggested by the political analogy, namely that tenure limits, like the now discredited age limits, are often simply an excuse for less than "particularly rigorous" assessment of performance. Facing up to performance issues will address the concerns that lead to this debate, and would obviate the need for tenure limits. The focus should be on succession planning, to ensure accountability and fresh strategic inputs, while keeping the board at a manageable size. Perhaps size does matter, and that is a question for another day.