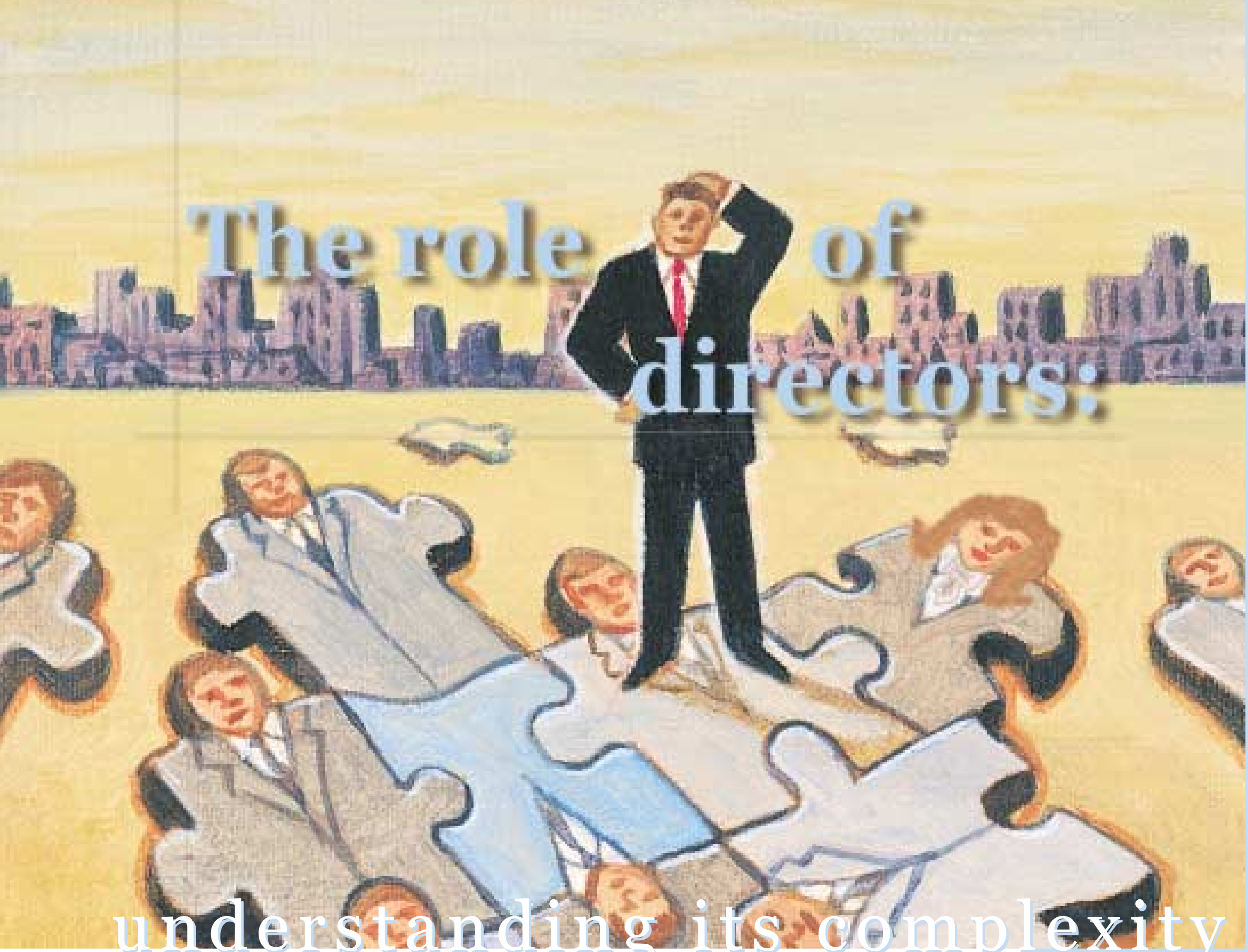

The role of directors: understanding its complexity

by Denis Pouliot

In the course of their careers, professional engineers will assume considerable and varied responsibilities. For some, this will include serving as a board member. The role of director can be rewarding both personally and professionally, and may be a viable career option for many engineers. It is also an opportunity to contribute to the growth and prosperity of the community. With this in mind, it is worthwhile to understand the nature and complexity of the director's duties.

In recent years, the role of board member has evolved significantly. At one time, the board's function was mainly to passively oversee and approve the plans of the management team. However, this has changed and several factors have influenced boards to play a more proactive role in the management of corporations. Notable among these factors are amendments to the *Canada Business Corporations Act* (CBCA) and guidelines introduced as a result of the *Dey Report* in 1994 and, more recently, the *Saucier Report* of 2001[1]. Each of these acts and reports calls on directors to provide stronger and more independent guidance and auditing. As the latest annual *Board Index*[2] by governance experts Spencer Stuart and the University of Toronto's Clarkson Centre points out, boards have become "smarter." They are now more actively involved in company strategy and management accountability.

But what exactly does this mean? What is the role of a board of directors and what are some of the challenges its members face?

From a very macro perspective, the role of a board of directors can be understood this way. Shareholders are the owners of corporations. As such, they have an interest in the well being and running of the firm. However, since supervising the activities of the corporation themselves is generally impractical, a board of directors is introduced as the instrument with which the shareholders safeguard their investment. The "board," then, is the legal identity that manages the corporation, and the "directors" (its members) are the participants that assure the board fulfils its responsibilities.

On a micro, more practical level, the board's role is much more specific. David Leighton and Donald Thain in their book *Making Boards Work*[3] define the duties of the board as follows:

1. Directing and supervising strategic management: the integrated planning and implementation of the major changes needed to improve corporate performance.
2. Appointing and overseeing the CEO and other officers.
3. Representing shareholders and maintaining shareholder relations.
4. Protecting and enhancing the company's assets.
5. Fulfilling fiduciary and legal requirements.

As well as accomplishing these tasks, there is also the expectation that directors will maintain a prescribed standard of care while doing so. When discharging their duties, the CBCA states that directors must "act honestly and in good faith with a view to the best interests of the corporation,"[4] and "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."

The challenge facing a director is to carry out the duties and responsibilities listed above with the expected standard of care. The consequences of failing in this endeavour have been made clear by recent high profile corporate meltdowns. And these have resulted in added pressure on boards, as directors become more actively involved in, and accountable for, the management of a company. This increased activity and diligence is at the root of the complexity of their role. There are many factors, some old, but many new, that must be taken into consideration when overseeing a company.

Examining the most prominent of these will shed light on the intricacy of the board's responsibilities.

Nature of business

Understanding the nature of a particular business and what differentiates it from any other business in the same competitive space can require both technical expertise and business acumen. It is the starting block of a company's strategy.

It also necessitates an understanding of the societal "subsystems" that will influence a company's prospects. These include: the political climate, the economic context, societal values and technological advancements. Although not all of these will be crucial to a firm, their potential impact must be recognized.

The political climate may be a boon or devastating blow to a company. Consider the anticipated repercussions of the Kyoto Protocol on the petroleum and alternative energy industries to appreciate the influence of political events on a company.

A director must be aware of the economic context in which a firm operates, whether the firm is a player in a community or in the global marketplace. This involves an understanding of both the industry and external economic factors that may be relevant. These can include issues ranging from industry life cycles and structure to economic forces influencing demand.

Cultural or societal values can also have a considerable effect on the decisions of a board. If the nature of a business is in conflict with these norms, for example, this must be factored into a director's assessment of management's strategic planning. Boards of companies developing knowledge and processes in the field of stem cell research face such issues.

Technological advancements can also be a major consideration. For example, a food processing firm, making use of relatively new and controversial technology like nuclear irradiation, may need to anticipate particular challenges, including legislative controls, economic hurdles or public opposition; any one of which could undermine a business.

Stakeholders

The shift from considering only the interests of shareholders, to taking into account those of all stakeholders is becoming more prevalent in business today. This makes it incumbent upon directors to be concerned about a much broader spectrum of players, including employees, pensioners, customers, suppliers and the community, to list only some. While practising good corporate citizenship was always a good idea, it is now, more than ever before, demanded of directors.

Government

The various arms of the government–legislative, administrative and judicial–can also affect a firm and boards should appreciate this. With their mandates to protect the public, both the federal and provincial governments have created legislation and policies governing companies and their boards.

The legislative arm often reacts to social, political or economic pressures in drafting new laws. Amendments to the *Canada Business Corporations Act* (CBCA) dealing with the liabilities of directors in 2001 are an example of this tendency. As well as knowing the CBCA and the applicable provincial corporations laws, directors should be aware of other kinds of laws that may affect how a company operates, such as security, environmental and labour laws, to name a few.

The administrative arm of the government, which regulates taxes, can have significant impact on the performance of the corporation. While not all directors will be versed in tax laws and their implications, the board as a whole should have the capacity to negotiate these issues competently.

Finally, the judicial arm of the government may be uniquely relevant to the aforementioned company involved in stem cell research, but will also be universally relevant to all companies in its efforts to enforce laws relating to corporate governance. Director liability, and "Director and Officer" insurance are subjects all board members should be familiar with.

Development stage of the business

How a director fulfils his or her duties will also be affected by where the organization is in terms of its development. The challenges of an early-stage company–inexperienced management, a lack of established procedures and policies, and perhaps fewer members on the board to spread the work around–can be daunting. But securing a directorship with a mature company may not make things simpler. Indeed, some directors will find the very opposite of these early-stage conditions–entrenched management and processes, and too many "chiefs" in the boardroom–to be the real challenge. Either way, the development stage of the business will contribute to the uniqueness and complexity of the experience.

Ownership model

Company ownership can take several forms and each of these can have considerable influence on how boards fulfil their roles.

In privately owned companies, the role of the board of directors can be more of an advisory nature. In particular, friends called upon to act in this capacity might not be endowed with any formal power and instead will contribute through influence and counsel.

In the case of a company with a majority owner, the board will have to deal with situations when this “controlling block” interest may not be completely aligned with the remaining (minority) shareholders. The director will then have to balance the influence of the majority holder, with the rights and interest of the minority.

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Companies with minority control blocks may be no less complicated. And if a minority owner is able to rally sufficient support to obtain a voting majority, the director may face the same predicament as above.

Finally, in companies with widely held ownership, like Professional Engineers Ontario, the board’s mandate is to work in the interest of all the shareholders. While this is the most conventional environment, it, too, involves challenges.

Composition of the Board

Intentionally saved for last, this is a catchall topic that can incorporate myriad issues. The old adage, “You can choose your friends, but you can’t choose your family” could just as well be reworked into an observation on boardroom composition. In most cases, you will likely not be in a position to alter the make-up of the board, so understanding the subtleties and complexities of its players and their relationships will go a long way in helping you maximize the board’s value to the firm.

Aside from the obvious importance of things like respect, frankness and general “chemistry” within the group, there is another facet of board composition that merits examination.

A director’s relationship with the company can prove to be a crucial determinant of that member’s contribution and role within the boardroom. In general, there are three types of directors. An “inside” director is a board member who is also a member of the management team of the company; for example the CEO or CFO. An “outside” director is a director who is not a member of management. “Independent” director refers to an outside director who is unrelated and who is also unaffiliated with a significant ownership interest in the company. In PEO’s case, the non-professional engineer Councillors appointed by the Ontario government fulfil the role of independent directors.

Since the primary role of the board of directors is to oversee and approve the management team’s running of the company, it is not hard to see how simultaneously being on that management team might influence your effectiveness as a director. It is something of a catch-22 that has been recognized in each of the major reports on corporate governance since the *Dey Report* of 1994. Increasing the presence of independent directors on boards has been repeatedly recommended. One of the obstacles to following this advice has been the inability of companies to find qualified candidates. This is especially true for emerging companies with limited resources. Their personal and professional networks are not broad enough and they lack the financial means to enlist an executive search firm.

This article has attempted to touch on some of the complexities inherent in the corporate boardroom. A director conscientiously fulfilling his or her duties will have to manage a range of challenging factors: the nature of the business, stakeholders, government, stages of development, ownership types and boardroom dynamics. But all this is not to discourage the potential director candidate. Although challenges exist, the rewards for the individual and the community outweigh them. And the demand for ambitious people with expertise and ability has never been greater.

Finally, for those made hesitant by the challenges outlined in this article or by the media’s cry for better governance, there is help. Organizations like Build the Board Canada, and the Institute of Corporate Directors provide resources and support for the novice and experienced director alike. Build the Board Canada also provides an online service that helps match executives with companies seeking board members. The opportunity and resources are there if you have the inclination to face the challenges and complexity of the boardroom

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