Diving for pearls: the importance of Board induction and re-induction

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Abstract: In 2003, the Combined Code emphasised two important aspects of Board contribution: the importance of induction for newly appointed Public Limited Company (PLC) board members, and appropriate training and development for all directors serving on a PLC board and its delegated committees, including the Audit and Remuneration Committees.

This paper explores the principles of good induction and re-induction programmes for boards of directors and trustees, and its conclusions draw on the author's previous research on non-executive contribution (Long, 2004; Long et al., 2005) and her recent experience of reviewing board and committee performance and effectiveness through Boardroom Review.

Keywords: induction; non-executive directors; board performance and effectiveness; board contribution; corporate governance; Combined Code.

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1 Introduction

An effective induction is essential for new board members if they are to maximise their contribution within a reasonably short time scale. There are always aspects of board structure, process, culture and life cycle which are unique to every company and which influence the board's long-term capacity for effectiveness; even the most experienced board member can benefit from learning about these aspects in a tailored and personalised induction programme before joining the board.

Published in 2003 by the Financial Reporting Council, the UK's Combined Code emphasised two central aspects of board contribution: (1) the importance of induction for newly appointed Public Limited Company (PLC) board members and (2) appropriate training and development for all directors serving on a PLC board and its delegated committees, including the Audit and Remuneration Committees. Under A.5 of the Code: Information and Professional Development, the main principle states: "All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge" (p.9). The code suggests that it is the Chairman's responsibility to ensure a 'full, formal and tailored induction' for all directors joining the board, including an opportunity to meet major shareholders (A.5.1, p.10), and to ensure that directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and its delegated committees (p.10) in order to enhance the board's overall effectiveness as a team (p.61). The code proposes that it is the company's responsibility to provide the necessary resources for developing and updating directors' knowledge and capabilities, and the company secretary's role to facilitate induction and professional development as required (p.10). An induction check list is included within the code (p.75).

The Combined Code recommendation for induction into the Audit Committee is even more specific, suggesting that the programme should cover the role of the audit committee, including its terms of reference and expected time commitment by members, an overview of the company's business, which identifies the main business and financial dynamics and risks, and meetings with staff. The code recommends that audit training should be provided on an ongoing and timely basis, and should include an understanding of the principles of and developments in financial reporting and related company law through a variety of methods including attendance at formal courses and conferences, internal company talks and seminars, and briefings by external advisers (p.50).

Individual members are also given personal responsibilities under the Code: Higgs (2003) recommends that "a non-executive director should insist on a comprehensive, formal and tailored induction. An effective induction need not be restricted to the boardroom, so consideration should be given to visiting sites and meeting senior and middle management" (p.63) and goes on to state: "once in post, an effective non-executive director should seek continually to develop and refresh their knowledge and skills to ensure that their contribution remains informed and relevant" (p.63).

Interestingly, although the code's main principle refers to all board directors, the recommendations in the supporting principles appear to apply only to non-executive members, and are silent regarding the induction needs of executive directors who are joining a PLC board for the first time. Furthermore, although the code applies to PLC boards of directors, it is worth noting that the principles of good induction apply to all decision-making bodies including the boards of private companies, charities, government bodies and professional membership organisations.

2 A slow beginning

In emphasising the importance of a good induction process, the Combined Code was suggesting something which many established boards of directors had already implemented and formalised. However, this was not always the case: Bob Garratt (2003) notes that in the 1970s "something mysterious and unassessable called 'experience' was deemed sufficient to get (directors) through to their retirement", and even in 2003 a MORI Poll, conducted on behalf of the Higgs' Review (2003) and involving 605 interviews with directors of UK listed companies, revealed that although 81% of non-executive directors received a briefing before starting their role, only 24% received a formal induction post-appointment. Companies appeared to be more concerned with introductions than inductions, and many non-executive directors were left to instigate their own informal induction programme when joining a new board (Long, 2004).

Due to recent external pressure by shareholders and regulators, an increasing complexity of operations and globalisation in most large companies, and non-executive persistence, there is evidence that PLC induction is becoming an institutionalised process (Long, 2007), although many directors involved in board and committee effectiveness reviews conducted by Boardroom Review have concluded that there is still significant room for improvement in the design of and preparation for induction programmes, and a pressing need to tailor and update programmes over time. Due to levels of price-sensitive information, the process tends to be executive-led; most companies now have standard programmes in place, and the best induction programmes are designed and tailored for each new board member (executive and non-executive) with input from the chairman, the company secretary and the new board member collectively. This level of engagement requires a substantial time commitment and a coordinated approach between executives and non-executives, but as most PLC boards are modest in their attempts to refresh their members, the time and resource needed to tailor an individual induction process is relatively limited.

3 Setting the agenda

Ideally, the induction process should be designed to encourage new directors to gain sufficient knowledge about the organisation and the environment in which it is operating, in order to make an early contribution in the boardroom and establish individual relationships with the senior executive team which are built on confidence and trust; an informal contact between executives and non-executives signals organisational commitment and builds on knowledge which is, on the one side, likely to increase perceived credibility of non-executive contribution and the ability to assess executive talent (McNulty et al., 2002) and, on the other side, to decrease information asymmetry between board members. The process should familiarise new directors with the duties of their position, as well as encourage ongoing development and training and the concept of performance evaluation as an essential aspect of the board's life cycle (Nicholson and Kiel, 2002; Long, 2006).

The code recommends that the induction process builds an understanding of the nature, business and operations of the company through its coverage of, inter alia, products and services, group structure, board constitution, assets, liabilities and contracts, risks, key performance indicators and regulatory constraints, and that the programme should foster an understanding of key personnel by encouraging new directors to meet informally with senior managers and employees, visit sites and attend away-days, and become more aware of important relationships including customers, suppliers and shareholders.

Although every induction has different requirements and priorities, the questions posed by Lorsch and Carter in 2004 are a good starting point for most induction programmes and non-executive directors, covering, inter alia, the creation (and destruction) of shareholder value within the organisation, margin trends, the management of major risks, financial reporting issues and accounting practices, major projects and progress, employee morale and retention, market share and trends, branding and corporate image, competitive strategies, and the views of analysts and brokers.

An induction pack, which directors should receive well in advance of their first meeting, should include information on the issues noted above, including the legislative and regulatory environment and specific corporate documents such as the Memorandum and Articles of Association, Matters Reserved for the Board, Terms of Reference, Conflict of Interest policies, and any shareholder agreements or major service contracts. It may also include, inter alia, information on business strategy and activities, key shareholders and stakeholders, previous board and committee papers, financial data, the risk register, press cuttings, organisational charts, and information on service providers, bankers and advisors.

The induction programme should also explain how the board fulfils its key roles regarding strategic development, the stewardship of financial and human assets, and the expression of shareholder and stakeholder interests; new board members benefit from an understanding of how the board fulfils its responsibilities regarding strategy, financial monitoring, risk analysis and management, executive performance monitoring and remuneration, board recruitment, succession planning and leadership development, and communication with shareholders and stakeholders.

4 The importance of non-executive induction

Non-executive directors are always less knowledgeable about company operations than their executive colleagues, but this is most evident when an individual first joins the board (McNulty et al., 2002). Higgs (2003) notes: “To be effective, newly appointed non-executive directors quickly need to build their knowledge of the organisation to the point where they can use their skills and experience they have gained elsewhere for the benefit of the company” (p.47). Owing to the complexity and visibility of most PLCs and the frequent changes in corporate governance, regulation and financial reporting, there is a growing awareness of the value of formal and informal induction programmes, and a number of reasons for new directors to insist on a formal tailored induction programme which starts to investigate some longer term issues such as the balance between innovation and risk, the impact of policy and regulation, the monitoring of reputation and corporate consciousness, and the balance of creativity, agility and productivity. Induction priorities may include the following: (1) risk analysis, (2) board culture, (3) business operations, (4) executive teams and (5) information asymmetry.

4.1 Risk analysis

As corporate litigation increases, non-executive board members consider additional appointments to their portfolios with great care, seeking to identify individual needs in advance of joining a new board and attempting to balance a level of understanding which facilitates constructive challenge without becoming an expert in the business. The induction programme, although not considered a replacement process for proper due diligence, facilitates an initial analysis of corporate risk as well as an understanding of the time commitment and the key people.

4.2 Board culture

Although the code is concerned only with PLC directors, most organisations and individual board members benefit from a well-planned induction programme; its value is linked to the demands of specific organisational and board cultures as well as the competitive environment and its regulatory requirements. The process can encourage new board members to become familiar with specific corporate language and terminology, increasing the flow and interpretation of information amongst members (Nahapiet and Ghoshal, 1998); pluralist board members often adopt a language and a linear thought process which is unintelligible to the inexperienced, and which excludes those who are not familiar with board culture. Furthermore, specific organisations, industries and sectors have their own shorthand which relates not only to jargon but also to complex financial dynamics and stakeholder networks.

4.3 Business operations

The process of visiting sites and watching operations is considered, by non-executive board members, to be the most useful part of a good induction programme (Long, 2004); formal programmes which do not include exposure to operations may not capture the essence of the business and its risk profile, and will not begin the process of aligning expectations, priorities and values. Structural change, control systems, health and safety issues, and risks that are specific to complex businesses may not appear multidimensional unless experienced first hand.

4.4 Executive team

In addition to formal programmes, informal induction processes are viewed as essential, particularly for complex businesses. They allow new board members to identify for themselves those areas which require further investigation, and over a longer time period capture their individual needs; in many cases the lines between induction and development are blurred. Non-executives benefit from informal communication with executives, who behave differently outside a formal boardroom environment; the balance of power is temporarily reversed, management hegemony and agency issues are reduced, and executives appreciate the interest shown in their achievements. Furthermore, decision making takes place at lower levels in many organisations, and exposure to executives below the board increases the understanding of how decisions and actions impact on strategy and operations.

However, not all executives view the non-executive induction process as a valuable use of their time; an inquisitive board may spend a significant amount of time with an organisation, but not gain the knowledge that allows it to govern more effectively (Carver, 2003). Although executives are becoming more familiar with induction processes, recognising that it provides new board members with a necessary understanding of the business, the risks of unauthorised conversations and over-familiarisation are still a concern to CEOs and their senior colleagues.

4.5 Information asymmetry

In 1979, Williamson noted that aside from cost, there were two other main features of information impact on decision making; firstly that information can be held privately (information asymmetry), withheld or revealed strategically to influence the outcome of a decision, and secondly that as information is often complex, there can be a limit to the abilities of parties to a decision (information impactedness); agency theory indicates that information asymmetry plays an important role in determining board effectiveness (Jensen and Meckling, 1976).

Non-executive board members acknowledge that they are operating at a significance distance from management, unable to spend sufficient amounts of time with executives and suffering from information asymmetry, potentially giving management de facto control (Mace, 1971). Information asymmetry, often cited as a key indicator in management hegemony theory, is also suggested to be a key determinant of double agency theory (the misinformation between layers of executives) and, if present, may deny non-executive members sufficient information on management abilities and actions to make accurate judgements of performance (Sapienza et al., 2000). Non-executive control is limited internally through information asymmetry directed by management and through established and inhibiting board culture (Hill, 1995) often exacerbated by CEOs who do not appreciate or accept the potential and actual contributions of their non-executive members (Rindova, 1999). However, the literature indicates that if working relationships between chairmen and CEOs are strong, and there are close working and personal relationships between executives and non-executives based on trust and reciprocity, information asymmetry and fear of opportunism can be reduced (Gabrielsson and Huse, 2002); induction is a useful way to establish board relationships, values and expectations early in the board life cycle.

5 The importance of executive induction

Although the code does not appear to suggest that new executive board members have induction needs, newly appointed executives who have never served on a PLC board, and/or have only presented to the board as a divisional head, may need help in identifying ways in which they can broaden their contribution from an operational to a strategic perspective, expand their focus from divisional to organisational concerns and issues, and challenge their peers (or direct reports) in a constructive way. In 2002, Garratt observed:

> "Suddenly people who have been functional or professional specialists all of their working lives are deemed capable of knowing everything that is happening inside and outside their organisation, and can instantly generate

> imaginative business policies and strategies, debate courageously, and make wise risk assessments which lead to sound decision taking focused on adding shareholder value."

The priorities for executive board members may include the following: (1) the development of leadership skills, (2) fiduciary duties, (3) communication and (4) external induction.

5.1 The development of leadership skills

The most desirable personal attributes relating to directors are relevant to the role of a board member, whether executive or non-executive. The Institute of Directors' (IoDs') categorisation (1998), following on from previous research (Dulewicz et al., 1995; Dulewicz and Gay, 1997), identified six main attributes: strategic perception, decision making, analysis and the use of information, communication, interaction with others, and achievement of results. Other useful characteristics included courage and strength of character, common sense, tenacity, diplomacy and tact, wisdom and intellect. Many of these personal traits are components of leadership, and therefore relate directly to the role of the board in conducting the organisation's affairs, governing, guiding and motivating others; in order to enhance these skills, executives may wish to include leadership coaching and/or mentoring as part of their induction programme.

5.2 Fiduciary duties

Directors are jointly and severally responsible for the decisions made by the board and the actions of the company. Executive directors do not differ in law from non-executive directors, and the term generally refers to individuals who have two roles as a board member and a senior manager. In addition to their executive responsibilities, they have directorial responsibilities for the organisation's overall prosperity, and are expected not only to be informed about areas outside their executive responsibility, but also to bring views which are broader than narrow departmental or divisional matters. Although executives understand the complexities of operations, they are often unaware of the full extent of their legal and fiduciary duties, and wider duties and responsibilities to shareholders and other stakeholders, when joining the main board. An executive induction programme, which explains formal directorial duties and good corporate governance and encourages meaningful contribution to the board's work, ensures that executives see their appointment as more than a reward for long service or divisional performance.

5.3 Communication

Meaningful communication – communication that affects people's understanding, develops positive values and stimulates constructive debate and challenge – occurs through dialogue (Clutterbuck, 1998) and interaction with others, and new executive board members benefit from individual meetings with non-executive members and advisors, such as auditors and brokers, before attending their first meeting. Furthermore, it is important that the CEO acknowledges the twin responsibilities and accountabilities within his executive team and encourages executives to express their opinions openly within the board environment.

5.4 External induction

It is still rare for new executive board members to be offered internal induction opportunities, but occasionally external training and development opportunities are offered, provided mainly by the IoD, business schools and professional intermediaries such as the accountancy firms. These opportunities tend to concentrate on areas of specific expertise, such as finance and law, and are designed for both executive and non-executive board members. In addition to external courses, new executive board members can choose to be mentored on a one-to-one basis as part of their induction process; this allows executive members to talk confidentially to a member of their peer group from another organisation which has no conflicts of interest.

6 The importance of re-induction

As noted above, in addition to induction, the code recommends directorial development for board members. The concept of development is not new: following the Second World War, many companies attempted to rebuild organisational trust through training and development, job enrichment programmes and exercises which built on the concept of corporate culture (Child and Rodrigues, 2004). More recently, academic research has drawn attention to the need for a more formal approach to the development of executive and non-executive directors (Mileham, 1995a; Mileham, 1995b; Mileham, 1996). Although the literature gives little theoretical attention to the value of directorial development, stewardship theory indicates that companies can achieve increased directorial competence and empowerment through training and development (Davis et al., 1997; Hendry, 2002). Donaldson (2003) notes:

> "Just as there is no one prescription for corporate governance, there is no one correct way to train a new cohort of directors. I encourage those who conduct director training programmes to look beyond the traditional methodologies and include not only a study of law and business practice, but also an examination of the interpersonal human dynamics that influence a board and its decision making." (p.19)

Most established organisations acknowledge the responsibility to educate their board members without causing embarrassment or damaging self-esteem; during their term, board members rely on a variety of external development opportunities, including courses, seminars and workshops. Many of these incorporate a variety of formats such as presentation, role playing and group debate. In addition to receiving specific information on subjects such as remuneration and audit committee processes, board evaluation, accounting standards and regulation, board members benefit from the chance to meet each other and discuss relevant and common issues, and to add value across their portfolios with newly acquired knowledge.

However, external directorial training and development does not address the need for internal re-induction after a period of time on the board, and board members are often dismissive of the concept of re-induction as part of their ongoing development programme; non-executives who hold executive posts elsewhere have little time for additional internal development, and pluralists consider their multi-board experience as their main contribution, particularly if their portfolio covers a wide variety of industries and sectors.

The importance of re-induction is due to several factors. Companies, and the environment in which they operate, change continuously and aggressively in many sectors, and although new board members are introduced to business units and divisional heads at the beginning of their tenure, over time practices and personnel changes may affect strategic development and risk profiles. Furthermore, induction programmes are designed to cover an extensive range of issues at the beginning of a new director or trustee appointment, and board members can suffer from information overload at the beginning of their tenure.

However comprehensive an organisation's induction programme is and however careful an individual's due diligence process is, still most new directors and trustees in an induction programme will be unaware of the board's culture and the leadership style of its chairman – factors which heavily influence the board's capacity for effectiveness. Existing board members who go through a re-induction programme during their tenure will have a different approach, perspective and level of enquiry from those who have never attended a board meeting, and will be more aware of how organisational values and ethics, and board dynamics affect the key roles and responsibilities of the board and the decision-making processes.

7 The role of the company secretary

Often underestimated, the company secretary influences the effectiveness and efficiency of the board; he or she is responsible for board administration, preparing the board agenda, overseeing board information and communications, and ensuring the board procedures are followed and regularly reviewed. The Cadbury Report (1992) stressed the importance of the role of the company secretary:

> "The company secretary has a key role to play in ensuring that board procedures are both followed and regularly reviewed. The chairman and the board will look to the company secretary for guidance on what their responsibilities are under the rules and regulations to which they are subject and on how those responsibilities should be discharged. All directors should have access to the advice and services of the company secretary and should recognise that the chairman is entitled to the strong and positive support of the company secretary in ensuring the effective functioning of the Board … The Committee expects that the company secretary will be a source of advice to the chairman and to the board on the implementation of the Code of Best Practice." (p.24)

The company secretary is very involved with the mechanics of organising the board (Renton and Watkinson, 2001); the role encompasses a variety of duties relating to the board including, inter alia, ensuring that there is a good information flow between the main board, its delegated committees and individual members, and that the procedure for the appointment of new directors is properly carried out, as well as assisting in a tailored ongoing induction programme for all directors, which includes a formal assessment of specific training and development needs.

Although it is the Chairman's responsibility to encourage proper process, it is imperative that the company secretary tailors and facilitates the induction process for every new executive and non-executive member; he or she is the primary point of contact and source of advice and guidance for non-executive members, and can assist new directors in an early understanding of the business and their roles and responsibilities.

8 Conclusion

Board members are never too senior or experienced to benefit from a well-designed induction programme when joining a new board, and a re-induction programme when appointed for a second or third term; it is imperative, however, to tailor every programme individually to ensure that the induction process is designed to maximise individual and collective contribution through increased understanding and knowledge. In prioritising induction and development for its members, the board sets an example not only to its own members, but also to the organisation as a whole, and contributes to good corporate governance by increasing its credibility and transparency.

The value and impact of induction and re-induction programmes to individual and collective board effectiveness and performance have not been investigated empirically; further research is required in this field in order to encourage all decision-making bodies to professionalise their approach, and to benefit from best practice.

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