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Understanding the Power and Importance of the Board's Policy Making Role

A BoardPro Whitepaper

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Introduction

It is surprising how few boards seem to fully understand and apply the influence, achieve the impact, and obtain the benefits, available to them through their policy making function. It's almost as if this governance superpower is a secret weapon available and capable of being used by only a few. In this White Paper we will explain why boards should understand and make better use of their policy making potential.

Why do boards need to make better use of policy?

The reasons are simple. It is a constitutional reality that the 'buck' for organisational performance and wellbeing stops with the board. To fulfil this crucial stewardship responsibility a board must be able to provide effective direction and control to its organisation.

An increasing number of boards are recognising that their job is to lead, not to wait passively and then respond to what their executives want them to do. Saying that is not intended to diminish the importance of an effective executive team. It is just to recognise that in most organisations any authority their chief executives have, is delegated to them by their boards. This can be done deliberately and transparently, or by abrogation. If the latter is the case, it is unlikely that the board is discharging its legal and moral responsibility to 'direct and control'.

For a board to be an effective delegator it must first express its expectations as to how that authority will, and will not, be exercised. And that is a core task of the policy making function.

The importance of board policy making is underlined by the practical reality that that while boards have full time accountability they are typically only convened occasionally and for comparatively short periods. Most executives spend more time at work in a week than their board members spend together in a whole year.

Because, therefore, boards are time poor they need the equivalent of a remote control system. The board's policy framework is the tool by which the board directs and controls the organisation when it is not in session. A comprehensive, integrated policy framework allows the board to be fully accountable for the organisation's well-being and performance while, at the same time, letting its chief executive and staff 'get on with the job'.

What is 'policy' in the governance context?

In its most succinct form, a policy can be described as 'a decision made in advance'. A more extended description of the board's policy framework might be something like this:

An explicit and formal (i.e., codified) expression of the values and perspectives on which the board directs, controls, and gives legitimacy to organisational action

Such a definition points to the use of policy being a principled, systematic, and proactive way of the board directing and controlling its organisation. It is infinitely preferable to the sporadic, random, and mostly reactive interventions that constitute for policy-making in many organisations.

Governance policy does not only direct organisational activity towards consciously defined achievement but sets boundaries to contain undesirable activity. Ultimately, the board's policy framework is a reference point against which every organisational action can be evaluated.

Board-set policy: key characteristics

It is desirable that the board's policies:

- Actively embrace/encircle/guide/inform everything that could happen in the organisation, and do so proactively rather than 'after the horse has bolted'
- Be formally expressed, consolidated and easily visible and accessible to those expected to comply with them
- Be comprehensive and coordinated to avoid gaps, overlaps and inconsistencies
- Convey the board's expectations in a consistent and continuing manner, the latter being particularly important to smooth out transitions when board membership changes
- Be actively applied, reinforcing, and operationalising the board's primacy in the chain of command
- Be well supported through active monitoring and review, and through processes such as induction and board and staff training
- Be respected and consistently applied allowing those who must comply a reasonable interpretation of them, until there is an explicit change in policy

By contrast, governance policy is not

- A set of ad hoc, disconnected, and uncoordinated organisational 'band-aids' – effectively various forms of 'fix' applied, after the fact, to disparate corporate performance issues
- A compilation of prescriptive procedures. Unless relating, on occasion, to the board's own processes, board policies outline what must be achieved, and what must be avoided, without saying 'how.'
- Something expedient, made up on the spot to address a situation that has not been adequately thought through, or a convenient response to, for example, any challenge to the status quo

Board policy-making historically

What has been stated above does not mean that boards have not attempted to direct and control their organisations in various policy-related ways although, perhaps, without realising it. However, much of what might be considered board policy has been documented in ways and in places that are jumbled, fragmented and unconnected. Some examples include:

- **'Board charters'**
- **Statements of Intent**
- **Vision and values statements**
- **Strategic and business plans**
- **Instruments of delegated authority**
- **Chief Executive contracts and performance agreements**
- **Risk registers**

As well as these more visible forms of board pronouncement, a considerable proportion of board policy decisions are deeply buried in the minutes of meetings past, often forgotten, frequently contradictory and inadvertently and, sometimes willfully, misinterpreted, and misapplied.

How do organisations benefit when their boards are policy competent?

Its policy making function gives the board leverage over organisational performance well beyond any specific situations it might be forced to decide on. This gives the board time and 'bandwidth' to attend thoroughly to the matters which properly justify its energy and attention and express its expectations of them in widely applicable policy terms.

Effective policy-making allows a board to influence everything that is IMPORTANT without feeling obliged or justified in making detailed decisions itself, particularly those that relate to routine or even out-of-the-ordinary operational matters. A policy statement can be extremely powerful even at a relatively high level of abstraction.

In undertaking the necessary delegation of its authority, the board allocates decision-making rights - particularly between the board and management. In the process the board creates the foundation for a clearly defined accountability framework that ripples out through the whole organisation.

Policy making is implicitly also about setting decision-making criteria and organisational performance expectations. Thereby, the board creates a framework for performance monitoring and ensures that all parts of the organisation are aligned in pursuit of a clearly defined vision of success.

For both board and management, the kind of discussion required in the development of policy is considerably more satisfying than much of traditional board meeting content.

One of the most significant benefits is better use of organisational capability

Earlier we noted that a policy can be considered 'a decision made in advance'. In contrast, boards have traditionally operated by approving proposals brought to them by staff. Among other things this means that the board is often – with some justification – seen as a bottleneck for decision-making.

Because the board's criteria for approving such proposals are seldom explicit or visible in advance, much staff effort can be wasted in proposal rework and the additional delay involved. The need to fit proposals into the board meeting schedule also means that staffs' ability to respond to rapidly changing circumstances is restricted. Further, having to seek board approval can easily have a dulling effect on staff creativity when the surest approach is put up conservative proposals that the board is likely to approve rather than novel and possibly far more effective initiatives.

Ad hoc board approval is also problematic for other reasons. For example:

- It denies directors the time they need for recognising the opportunity and deciding the very policies that would make specific approvals unnecessary
- It freezes the detail of the decision effectively requiring further board agreement to any change. This is a further constraint on a chief executive's ability to make a timely (and effective) response to changes in the organisation's operating environment
- The act of approving entices the board to become party to detailed operational decisions. This undermines its ability to hold its chief executive accountable for those decisions because the question arises 'whose decision was it?'
- What can seem like relatively random, even inconsistent, one-off board decisions, can mean that policy/project/programme evaluation is difficult and organisational learning is retarded.

It is quite a different matter when board policies establish the criteria for approval of staff plans and proposals in advance. There are considerable benefits such as:

- Greater delegation is possible thus making board 'approval' unnecessary!
- Opportunities for Individual board members to exercise undue influence on specific proposals instead have to exercise influence by convincing their colleagues about the provisions of a generally applicable policy
- By its existence a policy establishes a clear reference point for implementation (compliance) monitoring which increases the likelihood that staff actions will be true to the intent of the board's policy
- When board policies establish the criteria for approval of staff plans and proposals it improves the sequencing of decisions (e.g., from general to specific; abstract to particular; problem definition to solution; and policy to decision). The decision 'cart' is attached to the policy 'horse', not the other way around.

Effective governance level policy-making requires both board and management to be able to make a clear distinction between 'ends' and 'means'.

Ends distinguish purpose from path, results from process, and where one is going from how one is going to get there.[1]

A distinction between ends and means is important as we will see in a later webinar that will go more deeply into the policy making process. It is important to acknowledge this distinction in this context, however, because of the interaction and potential confusion between the two. It brings the constant risk of boards being drawn into detailed operational activity at considerable opportunity cost.

1. John Carver and Caroline Oliver (2002). Corporate Boards That Create Value. San Francisco, Jossey Bass, Pages 20-21

A board's initial and arguably primary governance interest lies in the definition of ends - what is to be achieved through organisational endeavour ('what' must be achieved and 'why' - purpose, outcomes, results, impact).

However, as the old adage tells us, 'the ends do not justify the means'. The board necessarily, therefore, has an interest in means, in 'how' the ends will be achieved. Not all conceivable staff means (actions/activities, etc.) are likely to be acceptable to the board. The board must also, therefore, state in policy terms what means (or resultant situations or circumstances), would be disagreeable or unacceptable.

While what is to be achieved (ends) is best specified in an affirmative, prescriptive format, means - having to be controlled - are best dealt with by way of limitation or proscription. It is a distinction that many board members struggle with but is central to board policy-making effectiveness as we shall see below.

Policy-making example – 'The Budget'

Boards interested in using the inherent power of policy making will be likely to make significant changes in how they think about and spend their time on, for example, financial matters.

The board's financial responsibility is to:

- Provide assurance of organisational financial sustainability
- Ensure that financial resources are allocated towards the results the board expects the organisation to achieve (including meeting compliance requirements)
- Ensure that planned expenditure is prudent

However, many boards exhibit a strong tendency to focus primarily on detailed budget content and approval and subsequent scrutiny of expenditure against budget. Although finance is just a resource, an enabler, in some organisations the budget is, in effect, the primary business plan.

When these tendencies are present a board is involved in financial management rather than financial governance. This is problematic for several reasons:

- It freezes the numbers in the budget
- The numbers are not the right ones in the first place. Budgets are usually structured in terms of inputs and operational categories (administration, marketing, travel, etc.) rather than the organisational outcomes that go to the heart of the organisation's purpose (reason for existence)
- It encourages board members to second guess operational plans – this frustrates management, confuses decision-making rights, and dilutes and likely undermines management accountability (whose numbers does the 'approved' budget reflect, and whose decisions were they?)
- Board dialogue about the relative worth of investment in desired results and the principles and values which should guide budget design are crowded out by board preoccupation with controlling the cost of inputs ('the budget for paperclips is far too high').

Effective financial governance requires the board to get in front of budget preparation. It does this by creating a budget policy defining the criteria by which management's budget (financial plan) would be acceptable. This shifts the board's attention to whether or not a proposed budget demonstrates compliance with the board's budget policy criteria without needing to approve the budget per se. Relevant questions when the board is considering management's financial plan might include the following:

- Does the structure of the budget presented relate to the board's governance interests?
- Does the proposed budget adequately assign resources to achieving the board's outcome priorities?
- Does the budget acknowledge the board's risk appetite (e.g., cashflow risk, solvency, reserves, etc)?
- Does it enable the organisation to meet its compliance commitments?

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Conclusions

- The board's policy making role is at the centre of board effectiveness, efficiency, and accountability
- Governance policy making is the process of operationalising the board's role and its legal and constitutional responsibilities
- Governance policy is the expression of a board's principles and what it values in terms of the direction and control of the organisation
- Board dialogue that formulates and later addresses policy implications is stimulating and satisfying and has greater impact than the kind of one-off 'hit and run' deliberations that have been more common in boardrooms historically.
- Management planning is also better informed and more productive when preceded by board policy making

About the Author

Graeme is a governance expert, with 20 years' experience providing specialist advice on board and director effectiveness. He has served on a wide range of boards and as a chief executive reporting to boards. Graeme also publishes the Board Works periodical on governance effectiveness which has an extensive domestic and international subscriber base

Graeme co-founded BoardWorks in 1997, Australasia's first specialist governance consultancy. Since then the company has worked with over 600 client across all sectors. Graeme came from a series of senior roles in local and central government. He is now BoardWorks Practice Leader ensuring BoardWorks stays at the forefront of contemporary practice

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About BoardPro

We exist to increase boardroom productivity and create better functioning boards. We don't believe good governance processes should be left to the domain of larger companies. We know that all parties in a board/ management relationship want to use their time and resources most efficiently and productively.

We found that a product that helped with the processes, workflows and guidance to work on the right things was missing from the market. So we developed BoardPro in partnership with some of the best independent directors and most progressive CEOs

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