Indigenous Business Toolkit Project

Role of the Board of Directors

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July 2024

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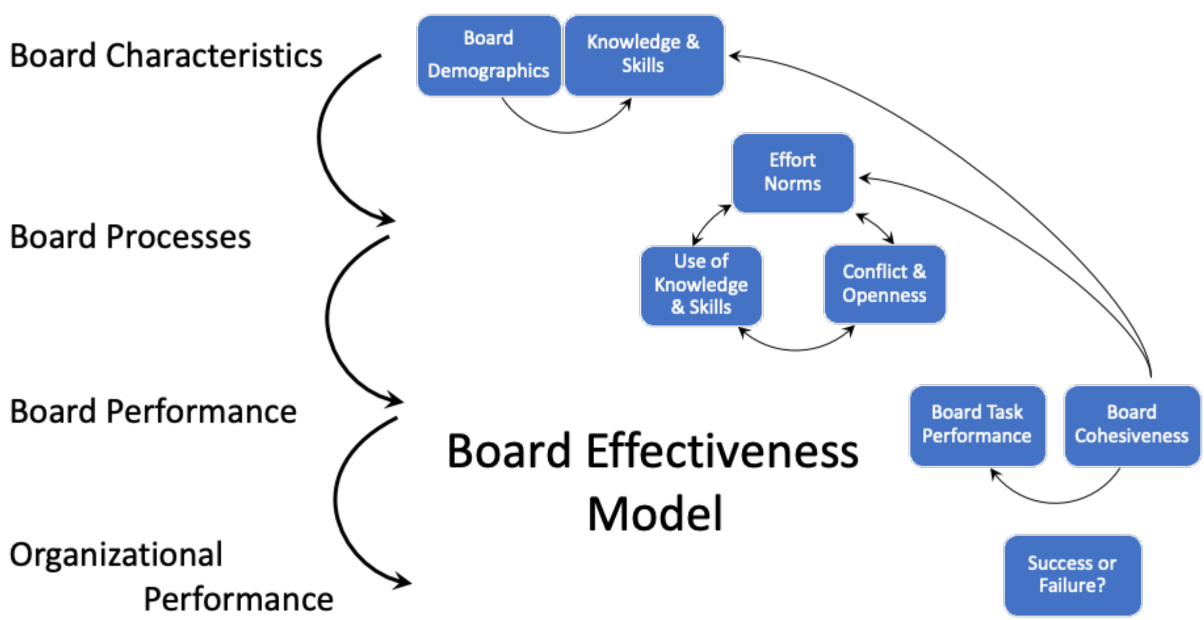
Summary

The purpose of a company's board of directors is to oversee and advise a company so it meets its objectives. Directors are fiduciaries – they have the legal duty to act in the best interests of the company and can suffer legal consequences (e.g., be sued) if they do not do so. The board carries out this duty through the decisions it makes – e.g., establishing a strategy to achieve the business's goals, setting appropriate policies to carry out this strategy, and making decisions on important things such as investments, hiring the CEO, monitoring the CEO's activities, and reporting to shareholders.

The most effective boards – the ones that make good decisions – have members with diverse skill sets and different points of view. Effective boards also have disciplined board processes that allow members to interact in a productive fashion and to deal with the inherent uncertainty present in business.

Figure 1 illustrates how the expertise, insight, and experience of board members are brought together to produce good decisions and good business outcomes. While technical skills, experience, and industry knowledge are important, soft skills and board processes – the way the board members use their individual and collective knowledge, as well as the way they deal with conflict – are also critical for strong board performance. Strong boards excel by providing oversight (e.g., monitoring CEO performance) and advice (formulating strategy and providing counsel to management), and in doing so ensure the proper management of the assets entrusted to them.



Source: Adapted from Forbes and Milliken (1999).

The Purpose of the Board of Directors

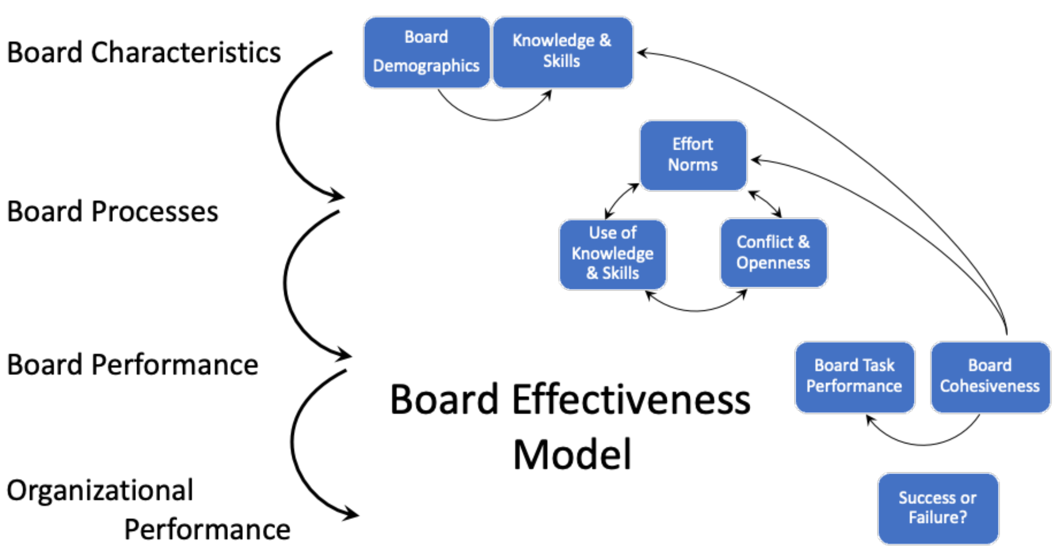
The board of directors is elected or selected by the shareholders to represent their interests and to oversee the management of the company. Since the shareholders do not typically have the time or expertise to manage a company, they delegate this role to management.

As the representatives of the shareholders, the board of directors have a fiduciary duty to act in the best interests of the company and its shareholders. The board carries out this duty through the decisions it makes – e.g., establishing a strategy to achieve the business's goals, setting appropriate policies to carry out this strategy, and making decisions on important things such as investments, hiring the CEO, and monitoring the CEO's activities. These decisions encompass the two key board tasks: (1) oversight (e.g., monitoring CEO performance); and (2) advice (e.g., formulating strategy and providing counsel to management).

Board Decision Making

Good boards make good decisions – i.e., decisions that create value for the shareholders. It is often believed that a good board is determined by structural characteristics such as the number of members (small is thought to be better), the age of members (not too old is believed better), and the existence of an audit and a compensation committee (having them is held to be better). Yet, the research does not bear out these relationships – e.g., small boards are not necessarily better, older members often bring important experience, and the presence of an audit committee does not guarantee good performance. Instead, the most important feature of an effective board is the ability of its members to interact in a productive way.[1]

Figure 1 illustrates the process by which the expertise, insight, and experience of board members is brought together to produce good business outcomes.



Source: Adapted from Forbes and Milliken (1999).

Figure 1. Board Effectiveness Model

Board demographics and the knowledge/skills of board members are an important starting point for board effectiveness. Board demographics include such things as experience and diversity, while knowledge and skills include knowledge specific to the business and more general business knowledge in areas like HR, IT, marketing, and finance.

Table 1 provides a listing of the knowledge/skills – the competencies – that board members should possess. No individual board member will have all these competencies but the board as a collective body should possess most if not all of them. Boards often develop a skills matrix to identify the characteristics they have filled on their board and the characteristics they are lacking. This information can then inform how the nominations committee seeks out new candidates.[2]

As Figure 1 illustrates, board demographics and knowledge combine to influence board processes. These processes revolve around three areas: effort norms; the use of knowledge and skills; and conflict and openness.

Table 1. Core Competencies for Board Members

Core Competencies	Details
Indigenous and Traditional Knowledge	Ensures a cultural match between a business operation and a community's beliefs.
Community Knowledge	In-depth knowledge of the shareholder(s) and what is important to them.
Collective Problem-solving Skills	Ability to listen to others' views, advocate their own views, identify common interests and alternatives, explore new ideas, and be open to compromise.
Strategic Leadership and Vision	Includes business strategy, vision, leadership, and management experience.
Financial and Risk Management	Ability to understand financial statements, budgets, and financial plans, and to identify and mitigate potential risks.
Industry Expertise and Market Insight	Knowledge of the industry, awareness of market trends, and an understanding of the competitive and regulatory environment.
Governance and Compliance	Knowledge of corporate governance, legal responsibilities, ethical considerations, compliance issues, and shareholder relations.
Human Capital and Organizational Development	Knowledge about human resources, talent development, and team building.
Communication and Perspective	Knowledge of relevant economic and political trends and the ability to communicate complex ideas clearly to various stakeholders.

Effort norms are informal rules – i.e., they are not written down – that specify "a group's shared beliefs regarding the level of effort each individual is expected to put toward a task,"[3] where effort refers both to the amount of time spent and to the level of engagement. Boards with strong effort norms generally perform better than those with weak effort norms. Since norms emerge from the actions of the group, new norms can emerge as board members or events change. As a result, board members must be vigilant in supporting strong effort norms.

While directors must have firm-specific and functional areas of knowledge, simply possessing this knowledge is not enough. Board members must also understand and respect the knowledge that their colleagues possess and be able to build on this knowledge in creative ways. In short, effective boards must be able to coordinate the expertise of their directors to make good decisions about the problems they face.

Good decision-making processes should also have conflict, providing it is of the right type. Cognitive conflict – or conflict about ideas – is typically beneficial. Because boards face challenging, complex problems, bringing a new perspective to a problem or critiquing other points of view can improve strategic decision-making. Boards without cognitive conflict run the risk of developing groupthink and of emphasizing cohesion and consensus over introducing and debating alternatives. Groups that use cognitive conflict to look at problems in a variety of ways have been shown to arrive at better decisions – in short, the existence of different views is an opportunity to arrive at a better solution.

However, not all conflict is beneficial. Affective conflict – or conflict about people and personalities – is typically detrimental. Conflict among directors can become personal when their worldviews, attitudes, or visions for the future of the organization are so different that they cannot be reconciled. Affective conflict can cause directors to direct less effort to preparation, engage less frequently in productive debate, and even leave the organization altogether.

Boards should seek directors who have diverse skills, life experiences, and worldviews, but share a common vision for the future of their organization. An effective board has directors who have a shared sense of responsibility and authority but are not so friendly or so similar in their thinking that they will not challenge each other's ideas. In short, board members should "be hard on ideas, but easy on people."

Strong board processes will lead to strong board performance. Board performance has two elements – board cohesiveness and task performance.

Board cohesiveness is the ability of board members to see themselves as a cohesive and effective team and to be motivated to participate in board activities and to remain on the board over time. As Figure 1 illustrates, board cohesiveness has a feedback effect on board processes and board characteristics. While some turnover in board members is expected, too much turnover is detrimental, since it means a loss of business-specific knowledge, a potential weakening of effort norms, and a possible reduction in cognitive conflict. As well, a lack of board cohesiveness can affect who is attracted to the board.

Task performance focuses on the board's ability to undertake its two key tasks: (1) oversight (e.g., monitoring CEO performance; hiring and replacing the CEO); and (2) advice (e.g., adoption of strategic plans; providing counsel to management). Strong task performance directly affects business outcomes (e.g., profitability, sustainability).

Task performance depends critically on the board's ability to gain a line of sight in four different areas – hindsight, oversight, foresight, and insight – all of which are crucial for a business's success and growth.[4]

1. Hindsight: Hindsight involves understanding events or situations after they have occurred. The board receives business and financial reports from management for the previous reporting period. While it is not possible to change what happened in the past, it is important to look at past events and to hold management to account with the intent of improving future performance.

2. Oversight: Oversight refers to the supervision, management, and care of a business. The board of directors is responsible to oversee the organization. This includes making sure the CEO is properly carrying out their activities, the company is compliant with legal requirements and regulations, and the company is following the policies set out by the board.

3. Insight: It is important for the board of directors to provide insight into the business. Directors are not involved in the day-to-day business affairs of the company. That is the job of management. However, directors can provide insight based on their experience and skills.

4. Foresight: The role of foresight involves the board of directors providing future and strategic direction for the organization. This is usually done with management.

Through these activities, a company can learn from mistakes, ensure that the right people are working in the right ways, and gain a deep understanding of the business environments in which it operates.

The Board-Shareholder Relationship

The board of directors is elected or selected by the shareholders to represent their interests and to oversee the company' management. To play this role, the board needs to capture and reflect the shareholders' interests while at the same time keeping and maintaining some independence.

Balancing the need for distance while capturing and reflecting shareholders' interests is difficult. Yet achieving this balance is critical to the business venture's success and the realization of the shareholders' goals. If the shareholder loses confidence in the company's leadership and governance practices, then the business will suffer because it is unlikely to get the resources it needs to operate effectively. Similarly, if the organization loses confidence in the shareholder, it may begin to focus more on its own interests and less on those of the shareholders.

The board's decisions should ideally align with the interests of shareholders, as both parties ultimately want the company to succeed and create value. At the same time, board members need to retain some independence from shareholders, since otherwise conflicts of interest arise and the directors may not be able to fulfill their fiduciary duty and act in the company's best interests. Board members should also maintain some independence from management, since one of the board's roles is to oversee and evaluate the CEO.

Effective communication and engagement are key to the creation of the mutual confidence necessary for business success. Communication and transparency are crucial to building trust and ensuring that board members understand the shareholders' values and goals and that shareholders are informed about the company's performance and strategic direction. Board-shareholder communication occurs through various channels, including annual reports, regular updates, shareholder meetings, and other opportunities for shareholders and directors to interact.[5]

Resources

Bachiu, V., M. Fulton, and K. Jackson. 2024a. Building a Board of Directors. Indigenous Business Toolkit Project. Johnson Shoyama Graduate School of Public Policy, University of Saskatchewan. https://www.schoolofpublicpolicy.sk.ca/research-ideas/projects-and-labs/indigenous- leadership-governance-and-development-project.php.

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Notes

[1] See Sonnenfeld (2002).
[2] Bachiu, Fulton, and Jackson (2024a) examine the process of building a board of directors. They also provide a sample skills matrix.
[3] Forbes and Milliken (1999, p. 493).
[4] Roberts (2017).
[5] Bachiu, Fulton, and Jackson (2024b).

Indigenous Business Toolkit Project

The Indigenous Business Toolkit Project is designed to provide Indigenous communities and individuals with the practical tools they and their advisors can use to undertake successful economic development. Indigenous economic development is more successful when everyone – community members, community leaders, consultants, business professionals, employees, and/or potential partners – understands its many aspects.

The Toolkit provides step-by-step instructions on selected aspects of economic development based on the best practices of leaders in the field. The modules in the Toolkit cover everything from the role of economic development in nation building, to the importance of business charters, to the various legal forms that can be used to pursue economic development, to the steps needed to identify and negotiate beneficial partnerships, to the governance challenges that economic development must address.

The modules are available for free and for use by anyone. The full set of Toolkit modules can be found at: https://www.schoolofpublicpolicy.sk.ca/research-ideas/projects-and-labs/indigenous-leadership-governance-and-development-project.php.

The Indigenous Business Toolkit Project is part of the larger Indigenous Leadership: Governance and Development project designed to support long-term Indigenous economic development. In addition to the toolkit, the larger project involves capturing the economic development experience of Saskatchewan Indigenous communities through a series of case studies. The case studies, along with a description of the larger project, can be found at the website listed above.

Disclaimer

The information contained in this document is designed to provide an overview of a particular topic and should not replace legal and other expert advice. Groups wishing to use the concepts discussed should receive the appropriate professional advice necessary to ensure their specific goals and circumstances are considered and recognized.

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