WHITEPAPER

THE FINE LINE BETWEEN “OVERBOARDED” AND OVERBURDENED

CRITICAL FACTORS IMPACTING THE EFFECTIVENESS OF “BUSY DIRECTORS” IN SOUTH AFRICA

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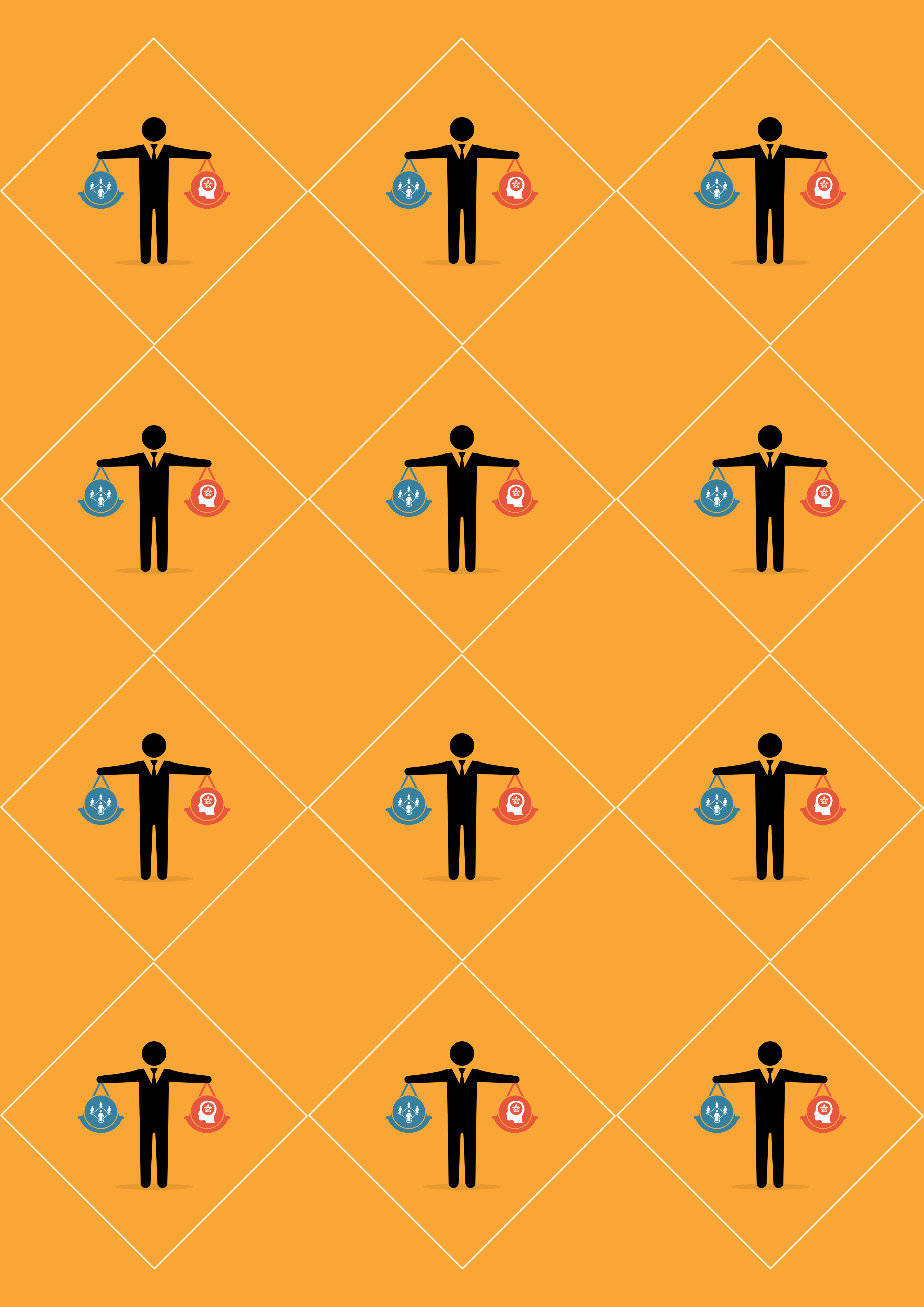

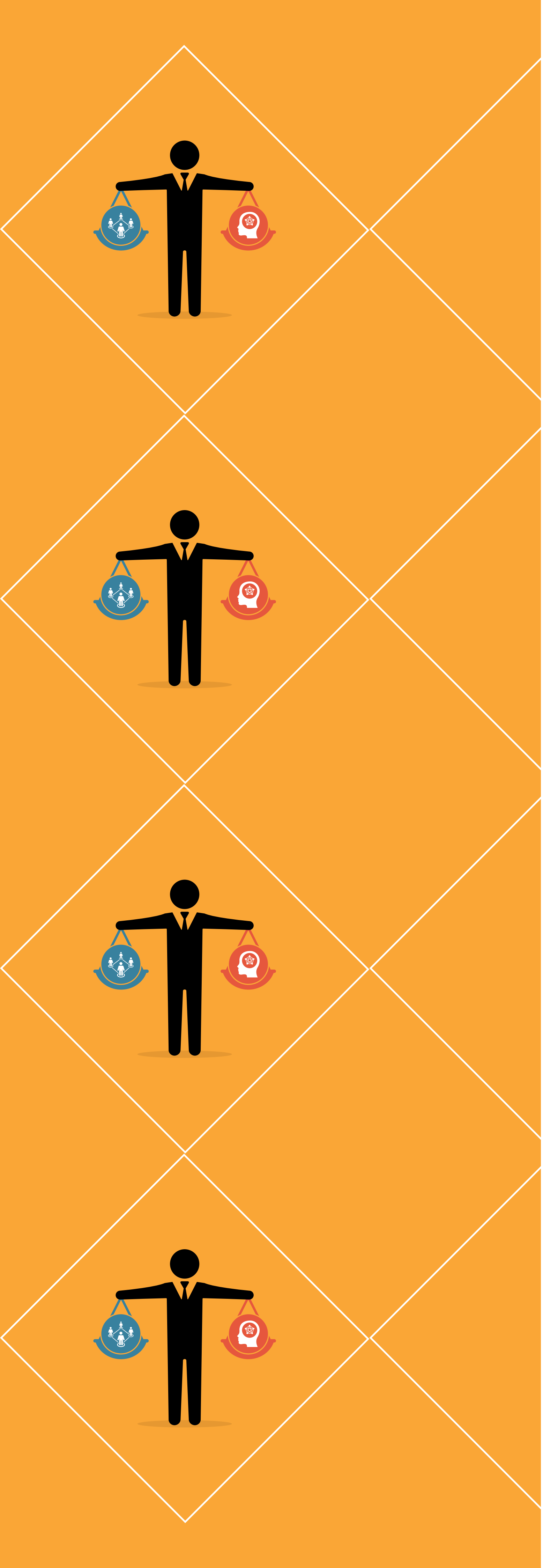

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Abstract

Neither the King IV Report on Corporate Governance for South Africa (Institute of Directors South Africa, 2016), nor the Institute of Directors South Africa (IoDSA) have, as yet, made recommendations about the number of directorships deemed acceptable for non-executive directors. Nevertheless, around the world, the impact of "busy directors" on business performance and their effectiveness in fulfilling their fiduciary responsibilities is a subject of academic and business debate.

Adding to a global focus on board effectiveness, South Africa faces the challenge of having a relatively small pool of competent non-executive directors (Natesan & Du Plessis, 2018a). Moreover, the influence of Broad-Based Black Economic Empowerment (B-BBEE) legislation creates additional demand for directors from historically disadvantaged groups, thereby further limiting the pool of qualified professionals.

A research project conducted by Mpho McNamee as part of her MBA studies found that, in the South African context, the importance of experience – and by extension, networks – in the board selection process was highly regarded by the experts interviewed. However, companies may be overlooking the critical importance of capacity that, when compromised, has the potential to negatively impact the performance and functioning of boards and organisations. The issue of board culture was also identified as a critical factor.

While limitations on "busy directors" have been imposed in regions such as Europe and North America, this whitepaper highlights how the particularities of the South African context may make similar restrictions unwarranted – at least for the time being – owing to the relative scarcity of certain skillsets and experiences within the current pool of potential directors. This whitepaper outlines a Director and Board Effectiveness Model framework to help sensitise directors, boards and companies to the considerations around "busy directors" in order to better understand the complex dynamics at play.

Keywords

"Busy directors"

Capacity

Board culture

Director effectiveness

Director training

The business problem

In a fragile and unpredictable global economic environment, coupled with high-profile corporate failures, the proficiency and effectiveness of the board of directors has never been more critical. Therefore, directors with the necessary skills, experience and networks are very much in demand. As a result, many now hold multiple directorships.

The impact of this trend, in terms of the potential consequences of overburdening directors and reducing the effectiveness with which they execute their roles, is increasingly being explored by both researchers (PricewaterhouseCoopers, 2019) and academics (Brown, Dai, & Zur, 2019; Hundal, 2017; Mans-Kemp, Viviers, & Collins, 2018) around the world. In some instances, the term "overboarding" has been adopted to describe directors who serve on too many boards (Harris & Shimizu, 2004), implying that these directors are overburdened by the multiple directorships. This has implications for quality and effectiveness.

DUTIES AND RESPONSIBILITIES OF BOARD MEMBERS

A board of directors has a fiduciary responsibility to protect shareholders' interests. This means guaranteeing that the business operates in an ethical and sustainable manner, ensuring other stakeholders' interests are being addressed, but not to the detriment of the organisation's bottom line (Falato, Kadyrzhanova & Lel, 2014). Along with their legal duties, directors must also ensure governance requirements are being implemented by the organisation's senior management teams (Adams, Hermalin & Weisbach, 2010).

Therefore, it is essential that directors are objective in their reasoning and decision-making without being guided by any personal interest (Deloitte, 2017). In South Africa, the responsibilities of directors are outlined in King IV (Institute of Directors South Africa, 2016), and are namely to:

- Give direction to the organisation's management and set and approve the strategic direction through the appointed governing body;
- Support the implementation of the organisation's strategy through the approval
- of policy and operational plans developed by management;
- Oversee and monitor the effective execution of the strategy by management; and
- Ensure accountability for organisational performance through reporting and disclosure.

The Companies Act 71 of 2008 as amended by the Companies Amendment Act 3 of 2011, which came into effect on 1 May 2011 (Republic of South Africa, 2011), legally binds directors in South Africa to a set of duties, responsibilities and obligations. In terms of section 66(1) of the Act (Republic of South Africa, 2009):

> the business and affairs of the company must be managed by or under direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent of this Act or the company's Memorandum of Incorporation provides otherwise.

This demanding position requires directors to display a competency profile comprising values, knowledge, skills and experience. This brings into question how directors can execute these roles, duties and responsibilities when serving on multiple boards.

Given these considerations, it is crucial to equip boards, businesses and non-executive directors with the necessary insights to make informed choices about the composition of boards, with particular emphasis on director effectiveness and the impact of board recruitment decision-making. In the context of holding multiple directorships, experience is just one component in a complex web of considerations ranging from capacity and board culture, to training and the value of networks.

POTENTIAL PROBLEMS

To steer organisations facing challenging and disruptive times, "busy directors" – like their peers – must ensure they are fit and prepared to manage and protect their organisations. Similarly, companies must ensure their directors have the requisite skills. If not, corporate failure becomes a real risk.

In recent years, notable corporate scandals include the likes of the US$7.4 billion Steinhoff accounting fraud (Motsoeneng & Rumney, 2019), the oft-touted Enron scandal of 2001, and the collapse of African Bank in 2014. In the case of the latter, the board was found to have been reckless and negligent in appointing an incompetent chief risk officer, extending the bank's loan book and allowing the chief executive officer (CEO) to dominate the board's decisions (Bonorchis, 2016). Furthermore, the capability of African Bank's board was cast in serious doubt after it was found that seven of the 11 members of the board of directors had no banking experience (Bonorchis, 2016).

IMPACT OF MULTIPLE BOARDS

Global advisory firm Institutional Shareholder Services (ISS) issued updated voting recommendations for shareholders in a 2016 Policy Update paper, which advocated lowering limits on multiple directorships from six board seats to five, while a 2012 Spencer Stuart survey noted that 75% of S&P 500 firms already had restrictions in place regarding the number of directorships their directors could hold (Ferris, Jayaraman, & Liao, 2017). Explaining its positioning in a 2019 memorandum (Papadopoulos, 2019), ISS noted:

> Market norms and expectations regarding the maximum number of boards a director may serve are evolving. In the decade since the financial crisis, increased investor scrutiny on board performance appears to have led to a decrease on [sic] the number of directors who serve on many boards. In the U.S., the percentage of non-CEO directors who sit on five or more boards has decreased by half since 2008 from 3.2 percent to 1.6 percent.

Globally, extensive research into the impact of holding multiple directorships on businesses has been conducted in regions like the United States and Europe. In the United States, the National Association of Corporate Directors (NACD) recommends that senior executives and CEOs hold no more than three board positions outside their executive roles (Ahn, Jiraporn, & Kim, 2010), and the Council of Institutional Investors (2016) recommends that directors with full-time jobs serve a maximum of two boards.

Can limitations imposed in developed world economies be successfully applied to emerging market companies? What is the ideal number of boards on which a director should sit without compromising quality? And, when there is a small pool of potential directors for a board, should there be a greater acceptance of the trade-offs required?

Why focus on “busy directors”?

Views are mixed on the issue of directors holding multiple board directorships, with concerns being raised that multiple board directorships are likely to result in the directors in question being spread too thinly (Fich & Shivdasani, 2006). This lack of sufficient “dedication” will result in lesser quality directorship decision-making and is associated with negative performance and company valuations, as Fich and Shivdasani (2006) explain in their “busyness hypothesis”.

Directors are considered “busy” when they hold non-executive directorships in three or more boards. Boards are considered “busy” when the majority of non-executive directors hold three or more directorships (Fich & Shivdasani, 2006). The likely outcomes of this “busyness” include diminished oversight of board functions and decisions (Lee & Lee, 2014), weaker corporate governance (Fich & Shivdasani, 2006), and a potentially negative impact on managerial oversight in the context of merger and acquisition decisions (Ahn et al., 2010), but only when the number of board seats exceed a certain threshold.

Alternatively, one could consider the issue in the context of the reputation effect (López Iturriaga & Morrós Rodríguez, 2014). This assumption highlights the quality and experience of directors with multiple board directorships, as well as their deep knowledge, business insights and specialised skills. As such, experienced individuals could offer value across a number of boards (Natesan & Du Plessis, 2018a).

PRESSURES ON SOUTH AFRICAN DIRECTORS

Currently, very little research focuses specifically on the South African situation or that of emerging markets when it comes to the issue of multiple directorships. That said, in recent years, a picture has begun to emerge of a growing trend towards holding multiple directorships – although the majority of non-executive directors in South Africa still largely hold just one board directorship.

In 2012, 910 non-executives served on a solitary board, compared with 421 who sat on two boards, 82 on three boards, 45 on four boards, and 13 directors on five boards (PwC, 2013). By 2019, 1 884 non-executive directors sat on one board, while 227 had two directorships, 70 served on three boards, 23 on four boards, and 12 on five board (PwC, 2020). However, on a year-to-year basis, these numbers vary widely, with 1 213 non-executive directors holding two board memberships in 2015 against 750 sitting on one board (PwC, 2016), and 1 004 directors holding two directorships in 2016 against 1 005 with one directorship (PwC, 2017). Notably, in 2016, four South African non-executive directors were recorded as serving on nine boards (PwC, 2017).

Despite this trend, thus far, the King IV Report on Corporate Governance for South Africa (Institute of Directors South Africa, 2016) and the IoDSA have not made recommendations around the number of directorships deemed acceptable for non-executive directors. Instead, limitations and research based on European and North American assessments of the impact of “busy directors” on business performance are superimposed on South Africa, without considering how the particularities of the South African context may make similar restrictions unwarranted.

South Africa faces the additional challenge of having a relatively small pool of competent non-executive directors (Natesan & Du Plessis, 2018a). Furthermore, the influence of B-BBEE legislation creates additional demand for directors from historically disadvantaged populations, thereby further limiting the available pool of directors.

Research approach

McNamee's MBA research study set out to explore the optimum number of non-executive directorships that directors should hold. The aim was to create a multiple director effectiveness framework to guide directors and recruiters on the subject of director effectiveness.

Thirteen in-depth qualitative interviews were conducted with five non-executive directors of multiple boards, five company secretaries, and three governance experts. The cross-sectional nature of the study aimed to achieve a richness of perspectives and a deep understanding of the many issues at play, thereby creating a framework for similar, comparative studies across other African countries. For example, the company secretaries interviewed had experience with directors of multiple boards and were able to bring their unique insights to the table, particularly regarding corporate governance in the context of the King IV Report (Natesan & Du Plessis, 2018b). The study did not include retired board members, company CEOs and company executive directors, which would have added additional depth to the insights harvested.

The questionnaire per subset group was structured to ensure that input would be similar and comparable for the data analysis stage. Among the questions asked, the following considerations were probed:

- The value "overboarded" directors bring to a board compared to those who hold fewer non-executive directorships.
- The importance of director experience.
- The potential pitfalls of using directors with multiple directorships.
- The factors directors should consider when accepting multiple directorships.
- The limitations associated with "overboarded" directors.

SUBSET GROUP	EXPERIENCE	NUMBER OF BOARDS/ YEARS OF EXPERIENCE
Board director 1	Politics and law	Eight boards
Board director 2	Finance and accounting	Eight boards
Board director 3	Law background	Five boards
Board director 4	Finance and accounting	Five boards
Board director 5	Engineering	Five boards
Company secretary 1	Law	Five years
Company secretary 2	Law and King Committee	15 years
Company secretary 3	Law	15 years
Company secretary 4	Law, accounting and King Committee	Six years
Company secretary 5	Law	Five years
Board expert 1	Executive recruitments	15 years
Board expert 2	Board director, recruitment	20 years
Board expert 3	Board director, policy and governance	18 years

Table 1: Levels of experience and professional competencies of interviewees

Critical factors

What follows are some of the key themes to emerge from the research, which turn the spotlight on noteworthy considerations, such as experience, training and effectiveness, capacity, networks and board culture. The specifics of the South African situation are also examined in the context of this feedback.

EXPERIENCE

The research clearly reflected all participants' agreement that experienced directors are highly sought after. As such, the probability of inexperienced directors being appointed to the board of a listed company remains highly unlikely – except if their technical skills are so unique that this factor transcended all other considerations. This need to appoint experienced directors feeds into the "busy director" phenomena, since directors who are perceived as having a high reputation effect (López Iturriaga & Morrós Rodríguez, 2014) would be invited to join multiple boards. So great is this clamour for experience that the potential impact on the director's capacity would be overlooked.

The executives interviewed ranked experience as notably important, behind how seriously the individuals took their director roles. These participants believe that directors of multiple boards across various industries could add value due to their exposure to issues experienced in other companies. They also felt that lessons could be drawn from those directors' experiences when dealing with similar issues on other boards.

One company secretary noted, "I have sat in so many board meetings where a director will say, you know chair, based on my experience in another entity we went through this or that. This worked or this didn't work."

It was evident from the results that the participants leaned towards finding a balance between busyness and reputational value, but capacity questions loom large. After all, if a director proves unable to resolve time and resource constraints, the value contribution to the various boards will be compromised.

TRAINING AND EFFECTIVENESS

A theme that emerged in the research process, and that warrants additional analysis, was the relationship between director training and effectiveness. It could be argued that directors of multiple boards would need specific training to ensure they are equipped to become effective on all the boards where they are active.

While training was viewed as a necessity by "busy directors" (Fich & Shivdasani, 2006) and company secretaries, it was not being prescribed and implemented at scale, nor was it a strong focus of boards. However, the importance of ongoing training was illustrated by the following comment from a board director: "...be very cognisant of what the new risks are ... and anticipate non-industry risks."

Applying the Director and Board Effectiveness Model to the issue of director training and effectiveness is illustrated in Figure 1. The figure indicates the effectiveness of a two-cycle process to avoid plateauing, but further upskilling and enhancing a director's contribution to the board.

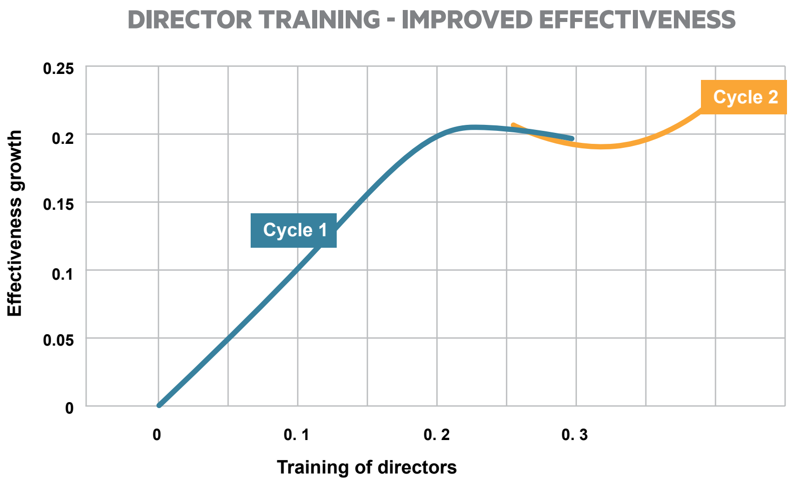

Figure 1: The relationship between training and effectiveness
Source: McNamee (2017)

CAPACITY

The issue of capacity as a constraint that can affect the functioning of boards in various ways – from board weakness to inefficiency – arose time and again in the findings. Nevertheless, the study failed to find consensus on a single standard for multiple directorships or how capacity might be potentially compromised. Instead, participants regarded the issue of capacity as being highly variable depending on, for example, the culture of the board, individual skills and experience, specific role and duties (such as chairman), and the nature of the business (for example, a bank as opposed to a public-sector body).

However, when seriously compromised, capacity deficits of board directors can negatively impact the performance and functioning of boards and organisations (Fich & Shivdasani, 2006). McNamee's research showed that in the context of capacity, the issue of "time constraints" was most frequently raised, behind "conflict of interest" and "conflicting schedules". This indicated a paucity of time was a particular issue for "busy directors".

As one board director explained, this consideration of time capacity should be used with decisions around when, or if, to take on new directorships:

> My rule of thumb is that when I take on something new, I must drop something. Or like in the case of Company A, I dropped three things because I was a chairman and it was a complex thing at the time. So the first thing is to be honest with yourself that you have the time and the willingness to accommodate.

Another board director also stressed the importance of understanding time commitments:

> I think you can wing it for one or two but you can't... You know, for people to recommend [you] to others, it means you have something to offer and I will say then, [it is advisable to] have a threshold for yourself where you're gauging whether you're offering what was sold to the people and that's what should stop you, not a number [of boards, but rather your own threshold aligned to your capacity].

NETWORKS

Most participants said recruitment was performed through the use of the trusted networks of existing board members. This highlighted the importance of being part of such a network as well as the risk of never being recommended as a board member if one fell outside of these trusted circles. As one board director commented: "Most of the boards have a decent network. And they would say 'so and so's' retiring we need another member; we would prefer a black female."

The role of trusted extended networks is, in part, dependent on a board's ability to build relevant networks in the necessary industries to gain access to key resources. Board members who are able to tap into outside links and networks are particularly attractive in conditions of scarcity (Salancik & Pfeffer, 1974). This has both positives and negatives, explained one company secretary:

> One would be naïve to think the old school or the old boy network doesn't work. Of course it does.... I would imagine that if you had to look at every director who sits on a public listed company board in South Africa, I would imagine that at least 75% of them have probably been introduced to that board by somebody else on that board who knows them.

BOARD CULTURE

The often interconnected networks of board members have an impact on the board culture. When a board is heavily reliant on its own network to recruit new board members, it diminishes the body's diversity in thinking. Scholars who have analysed board composition (Chakrabarty & Bass, 2014; Charitou, Georgiou, & Soteriou, 2016; Kang, Cheng, & Gray, 2007) put forward that when board directors recruit from their network, they tend to recruit people similar to themselves. This impacts overall culture and also has the effect of diminishing diversity. As one board director observed: "I think board diversity is quite important. The board ... the more diverse you are the more people raise different questions...."

Board culture, specifically how it reflects the conduct of the chairman, came through strongly as an important, underexamined theme during the interviews. Although several negative experiences of board chairmanship were conveyed during the interviews, it was clear that when board chairs kept firm hands on the tiller, ensuring that adequate preparation by all directors was an absolute necessity to serving on the board, it mattered less whether a director was a "busy director" or not, as they had little choice but to be effective.

The research highlighted the impact of board culture on the overall effectiveness of the board as a whole, as well as the effectiveness of individual directors. This was best guided by the chairman, company secretary and CEO working in tandem. One company secretary noted:

> ...the guides are there and the guides will always be there but the culture of the board and how the board functions is really informed by the leadership of that board, you know, the chair, the company secretary and the CEO together... that trio actually drives the ethics and the conduct of the board....

Figure 2 depicts the relationship between culture and effectiveness of applying the Director and Board Effectiveness Model.

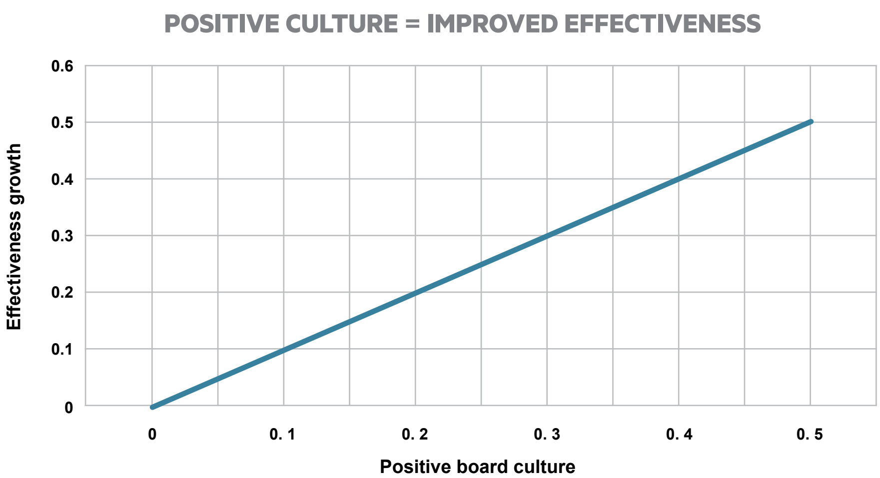

Figure 2: The relationship between culture and effectiveness
Source: McNamee (2017)

Figure 3 identifies the key inputs impacting the culture of a board. Factors such as the power dynamics of the chairman in asserting legitimate power over the CEO and the directors of the board, as well as company culture wielded notable influence.

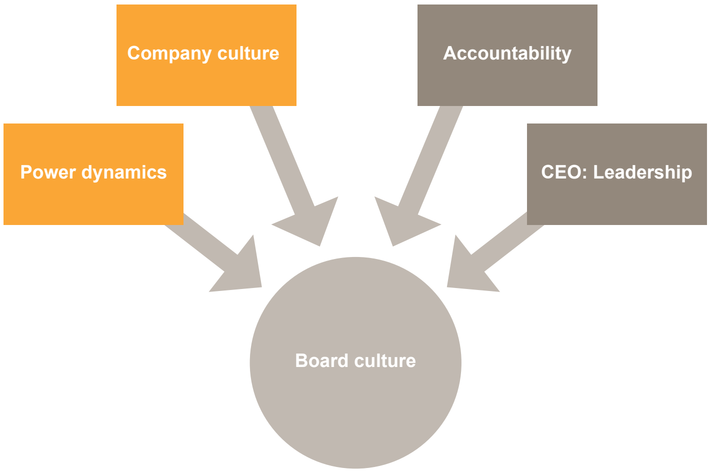

Figure 3: Inputs into board culture
Source: McNamee (2017)

SOUTH AFRICAN CONSIDERATIONS

While the above-mentioned critical factors apply across both South African and international boards, certain issues hold greater weight in South Africa due to the country's unique history.

Experience

With a relatively small pool of skilled and experienced professionals capable of taking on directorship roles, South Africa demonstrates an understandably high focus on director experience. Therefore, established directors with a solid reputation will be expected to take up more directorships (Lei & Deng, 2014).

South Africa also presents a unique example in the global framework due to the highly unequal historical relationship between different population groups, as well as the existence of post-apartheid transformation legislation. As a result of these factors, it would be reasonable to assume that the pool of experienced black directors is even more limited.

Capacity

South Africa's relative scarcity of potential board directors has shifted the discussion away from capacity to compliance. While understandable, a failure to acknowledge the issue of capacity constraints could have consequences for the functioning of individual boards, director effectiveness, and corporate governance as a whole.

The GIBS study found that "busy directors" in South Africa had ample opportunity to "stretch" their capacity, possibly beyond what is viable. This was, in part, due to the advisory nature of King IV as well as the fact that the issue of capacity was overlooked by boards during the recruitment phase in favour of diversity over effectiveness.

Networks

Recruitment internationally and in South Africa is still heavily reliant on the existing directors' network when appointing new directors. However, there is a growing use of agencies and recruitment firms.

The research highlighted that networks are still a key factor in recruiting directors onto boards in South Africa. Nevertheless, this poses challenges when looking to add new members or those with different skills, since it is highly likely that directors would choose to network with people who are similar to them in terms of thinking or professions. As such, this practice is limiting for adding diversity to boards.

Board culture

Driven by B-BBEE legislation, South African directors have a legal mandate to drive a transformation agenda within their organisations and the boards on which they serve. The majority of the participants highlighted that transformation was important in their organisations, with both gender and racial transformation ranking highest. This drive to recruit female directors and those from previously disadvantaged groups had the potential to fundamentally impact the culture of the boards on which these individuals sit, adding to board diversity.

While participants pointed out that transformation was still a key talking point on their boards, what was more important for them was to focus on getting the best candidate for the job. As one company secretary observed: "The management wants their board to be reflective of demographics; but first and foremost, wants their board to be peopled by the right people, who are experienced."

With a limited pool of black and female directors available to the market, South African companies continue to struggle with implementing transformation at board level. One expert observed that the current approach did not facilitate long-term cultural shifts: "I think they definitely all had a transformation agenda and some did better than others in executing it. The difficulty precisely of overly-prescriptive regulation is that it encourages box-ticking".

Dynamics impacting "busy directors" and effectiveness

Drawing on the findings of McNamee's research, the Director and Board Effectiveness Model creates a framework for directors, boards and companies to better understand the complex dynamics around "busy directors". The model attempts to encapsulate key factors – training, capacity, reputation and experience – that impact director effectiveness, creating a practical tool when trying to achieve effective boards and board directors.

The external influences identified in the model are: power dynamics; company culture; accountability; CEO leadership; and director network. The following internal influences are identified: capacity of directors to fulfil their duties efficiently; director training; relevant experience required to fulfil their duties; individual director traits aligned to the values and culture of the organisation; and the board's culture.

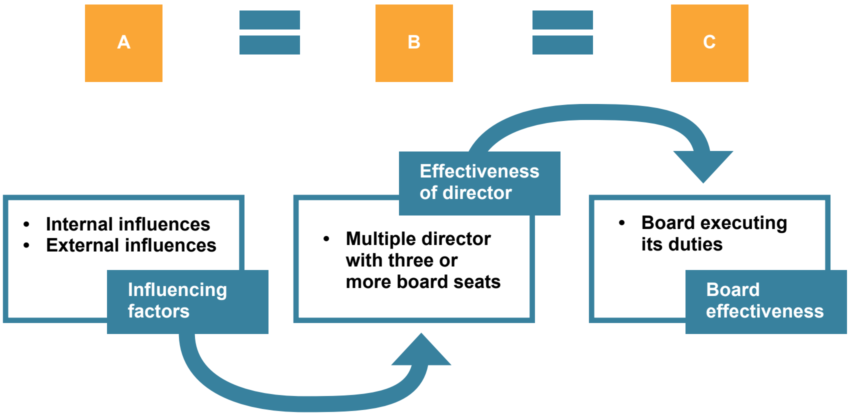

Figure 4: Director effectiveness research framework
Source: McNamee (2017)

As Figure 4 illustrates, the model is not linear and comprises external and internal influences on the board of directors, which impact effectiveness. The ability of the board to execute its duties and the role of individual director effectiveness must also be considered when building up a complete picture of board effectiveness.

THE GREEN CORRIDOR EFFECT

When external and internal influences are balanced, the Green Corridor Effect – which relates to a positive alignment between director effectiveness and company board culture – is created, resulting in high board performance. This process is also depicted as a continuous cycle in Figure 5.

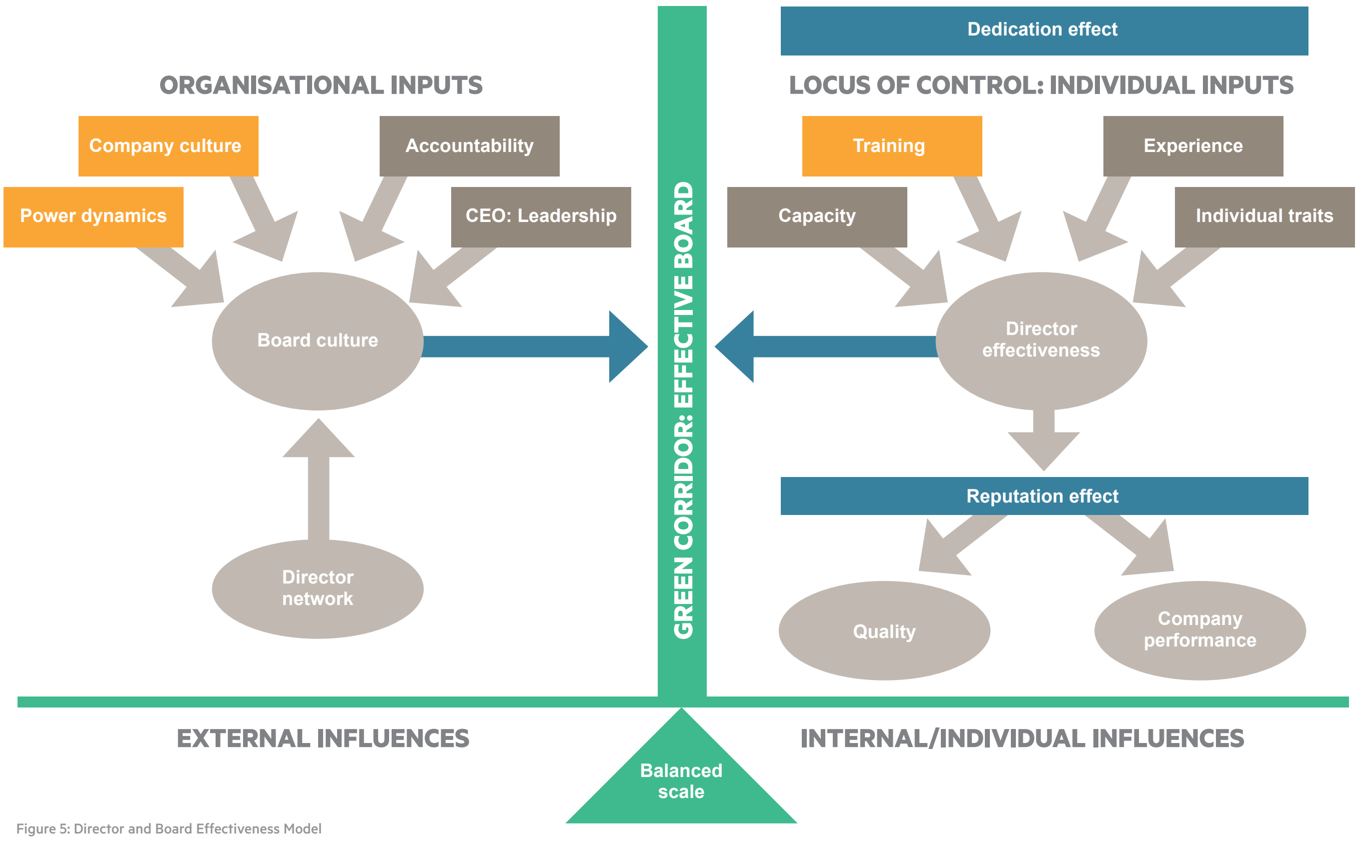

Figure 5: Director and Board Effectiveness Model
Source: McNamee (2017)

IDENTIFYING OUT-OF-BALANCE BOARDS

Applying the model can also help to identify cases where the external influences are out of balance and carry a heavier weight than the internal influences. For example, Figure 6 depicts how the company culture and power dynamics between the CEO and chairman are unbalanced. In such a situation, the CEO may be exerting power over the board, thereby affecting company culture and power dynamics, and weakening the importance of accountability and CEO leadership in achieving the requisite balance. This illustrates the importance of maintaining a careful equilibrium between external and internal factors when managing and leading organisations, as tipping the scales, even slightly, can have negative repercussions.

As Figure 6 illustrates, the external and internal forces operating on a board of directors are complex and often interwoven. To be effective, each director must strive to navigate through dynamic environments that may impact the business. As such, directors should aim to be agile in managing for change by considering the range of issues at play. Bearing this in mind, a simplistic view focusing on one aspect of the influences impacting director effectiveness cannot begin to paint a complete picture of the dynamics at play. Instead, it should be recognised that director effectiveness is a result of a balanced view of many variables. It is not and cannot be regarded as being a linear process.

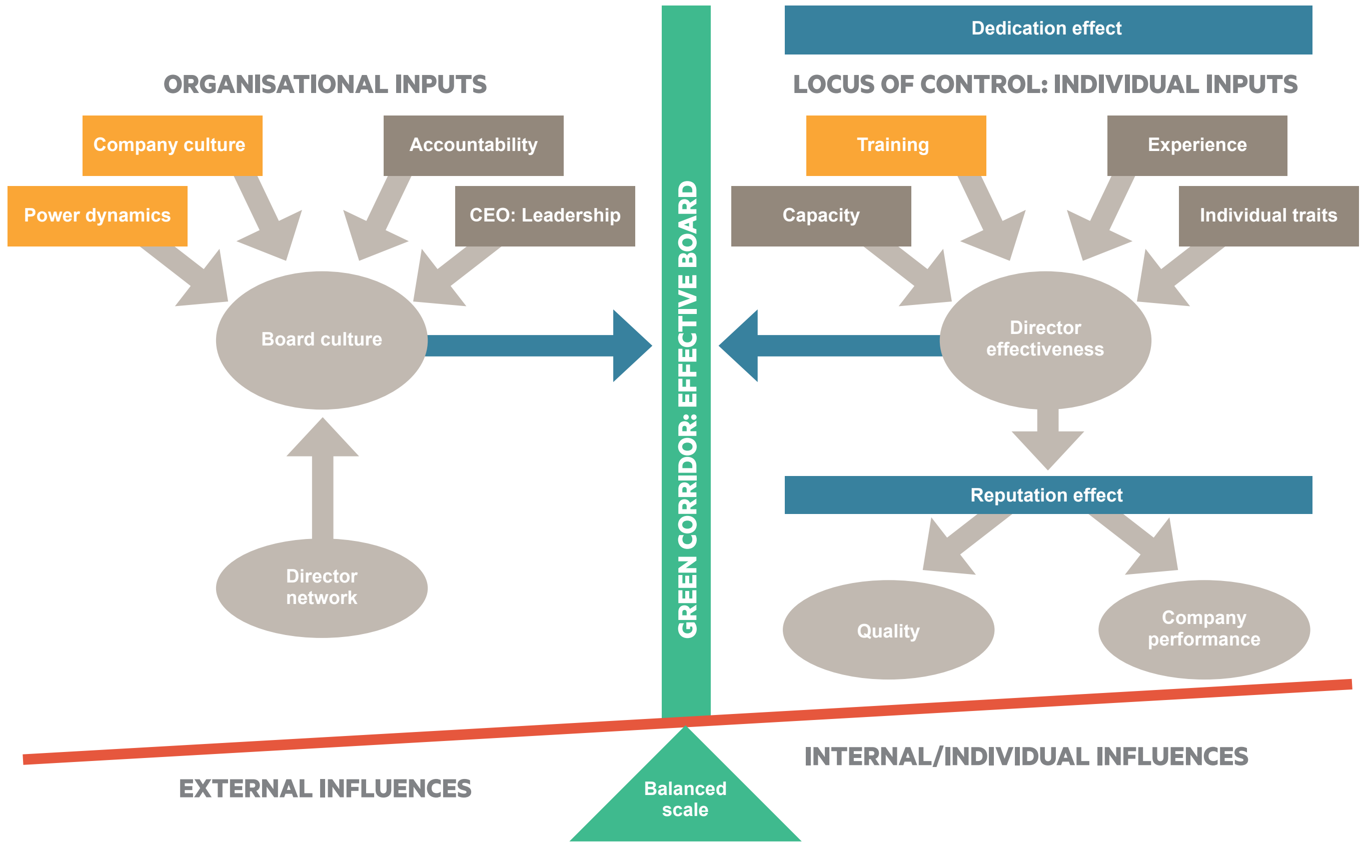

Figure 6: Director and Board Effectiveness Model – out of balance
Source: McNamee (2017)

Conclusion

What is the ideal number of directorships a director should hold? And is busyness the only factor at play when determining this figure?

Most of the participants in the research highlighted three board memberships as the most suitable number when multiple directorships are held. Those surveyed indicated that if a director was sitting on a selection of committees as part of a single directorship, or was committed to another executive role, then the capacity to take on three independent directorships may be affected.

Limiting directorships to a maximum of three is aligned with the suggestions by the NACD, which recommends that senior executives and CEOs hold three or fewer board positions outside of their executive roles (Ahn et al., 2010). The Council of Institutional Investors (2016) said that directors with full-time jobs should serve on a maximum of two boards and no more. This finding also aligns with Fich and Shivdasani's (2009) "busyness hypothesis", which deems directors of three or more boards to be "busy". As two board directors in the study noted:

> I think if you're going to continue with the other stuff maybe the three is a really good number.
>
> I would say if you're a new director I would probably go with the three that the King also recommends if it's not full-time. Say three boards to serve on a bank... with non-executive directors you're doing other stuff, this is not your day job.

As a counter argument, several respondents contended that the number of directorships was less important than the individual's work ethic and commitment, which together would dictate the maximum number of boards that are ideal for each individual. These observations highlighted the importance of considering each case on a director-by-director basis. This is particularly true in the South African situation, where critical factors around transformation and historical legacy may be resulting in a shift towards "overboardedness" and the phenomenon of "busy directors". What should not be compromised is the capacity of directors to deliver the quality and depth required of this vital oversight role.

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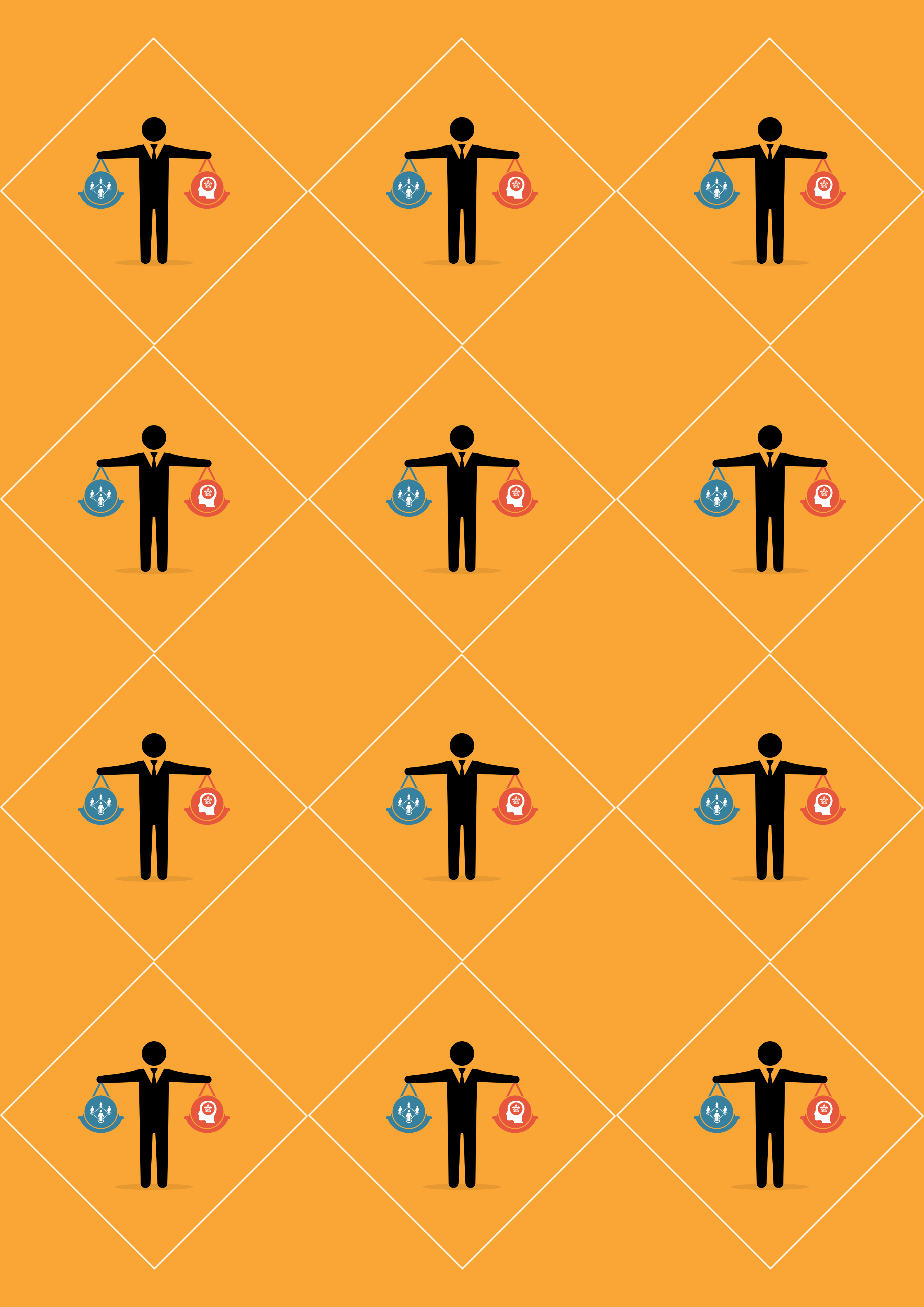

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