

# The Boardroom Report

## Privacy needs keep outsiders off family boards

**“EXTERNAL BOARD MEMBERS CAN PROVIDE ACCESS TO NEW SKILLS AND EXPERIENCE”**

A desire to keep everything in the family is discouraging family businesses from appointing outside directors to their boards and holding them back from maximising their potential.

A recent *MGI Australian Family and Private Business Survey* found that only 42 per cent of family businesses have a board of directors. Of those that do, 85 per cent do not have non-family executive directors on their boards, while 86 per cent do not have non-family, non-executive directors on their boards.

According to the findings of the survey conducted by RMIT University of 5,000 Australian companies, the main reason given by 53 per cent of family businesses for not having non-family, non-executive directors on their boards was a desire to maintain the family's privacy.

A further reason for the absence of non-family directors on the boards of 29 per cent of businesses was that they felt the skills required at board level already existed in-house.

However, Sue Prestney, executive chairman of MGI Australasia, says: “Maybe in some cases that's true, but it is hard to believe that many businesses could not do with an injection of skills or someone who could broaden their networks or access people of influence.”

She says it is concerning that 58 per cent of family businesses do not have a board of directors. “This is likely to mean there are many businesses that are not implementing sound corporate governance practices. A business without a formal board is more likely to concentrate on operational matters and neglect big picture issues. In many cases, there are no formal meetings being held to deal with strategy, risk management, regulatory compliance and other matters normally dealt with by a board.

“External board members can provide the business with access to new skills and experience, as well as to ambassadors to open up important networks for the business. They can also provide support and guidance to family business owners and valuable mentoring to successors.

“Importantly for family businesses, an independent board puts professionalism and objectivity into business decisions affecting family members. This will, in turn, assist in maintaining family harmony.”

So how do family businesses get across the privacy issue?

Prestney says: “You point out that directors have obligations under the *Corporations Act 2001* to act in the best interests of the company and not to use the information they obtain to cause detriment to the company or gain an advantage for themselves or someone else.”

She adds that the key is also to find the right person – “someone who has the personality, values and culture that will fit into your organisation so that you won't feel uncomfortable talking to them”.

While there are many ways to find the right person, she says it's often the accountants or other trusted advisers of the family business who can help. “They will have a network of people and know the business and the personalities involved well, and should be able to suggest people likely to fit and have the required skills.”

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## Getting value out of presentations to the board

Boards often have to sit through glossy presentations involving new projects or the purchase of new products and services. But how can they ensure they get the best out of these and don't have the wool pulled over their eyes?

Julie Garland McLellan, an experienced board director and author of *Presenting to Boards*, says the important thing is to know how every presentation fits into the context of the organisation. "That's a question of how it fits into the organisation's strategy; budget; whether it involves expected planned expenditure or new expenditure; and what liabilities will be incurred," she says. "Directors have to ask themselves: 'Do I understand this and the implications of the decisions I have to make.' It's also a question of knowing whether it's right."

Garland McLellan notes that some presenters have been advised to remove the difficult parts of their presentation or to structure it so the tricky questions don't arise, or make the presentation so long that there isn't time for the board to ask questions.

She advises boards to set limits on time and the amount of slides used, and to always ensure there is enough time for questions. "If you are running late, go straight to questions and miss the presentation. If the presenter can't cope with that then he or she isn't a good person to do business with," she says.

Traps could include the use of a lot of technical jargon or diagrams and spreadsheets that may look like gospel, but don't elaborate on the assumptions used.

Garland McLellan says: "If it's not clear in the presentation, ask the presenter for clarification. If it's not appropriate to ask the presenter, ask senior management when the presenter has left the room."

She adds that the timing of the presentation is also important. "Don't have presentations about big decisions too late in the day when everyone is tired or too early when directors haven't warmed up to the discussions."

Garland McLellan advises that the board minutes are produced within 48 hours of the presentation. "That way you still remember very clearly what you decided and why. Read the action items very carefully to ensure that is what you wanted. If someone who wasn't in the room reads this, would they understand exactly what you wanted the company to do?" she asks.

"You want the minutes circulated quickly because after a board meeting most good CEOs will sit down with their executive teams and debrief them on decisions made and what is expected to happen. You don't want the CEO to do that and then three weeks later, you get your minutes and say: 'Oh no. That's not what we meant' or 'That's not very clear', because the executives will have already started on the plan of action."

Here are some of the questions Garland McLellan believes directors should ask themselves during and after presentations:

- What are the processes and procedures required to make this work?
- How do we make sure this is properly implemented, reported and appropriately controlled?
- Do we have what it takes to implement this?
- What is the probability of success?
- What will we do if it doesn't go to plan?
- Who is going to do this? Have they been trained? Do they have enough experience?
- Is the ownership of the intellectual property clear?
- Who will be accountable for implementing this?
- Who needs to be told what?
- Is this in line with our organisation's risk appetite?

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## The message from Centro

Directors are entitled to rely on specialist knowledge and advice provided by management and external advisers, but there are limits to that reliance.

That was the message from the Australian Institute of Company Directors following Justice John Middleton's recent penalty decision for members of the Centro board found to have breached the *Corporations Act 2001* in relation to Centro's 2007 financial statements.

Justice Middleton fined Centro's former CEO Andrew Scott \$30,000 over his part in approving the 2007 accounts, while ex CFO Romano Nenna received a two-year boardroom ban. None of the six non-executive directors (NEDs) involved received fines or bans.

The Centro case has sparked ongoing debate over whether the judgements represent an application of existing law or new law in the area of directors' duties and the extent to which directors can rely on management and expert advisers to the company.

However it is interpreted, Company Directors says it highlights important issues for the director community and provides a reminder of the significant responsibilities that come with the role of director.

Justice Middleton found that the Centro board's corporate governance structures were in accordance with the Australian Securities Exchange's Corporate Governance Council's *Principles and Recommendations* and that all of the board's relevant corporate governance practices and procedures "were followed in the process of approval of the relevant financial statements" which were the subject of the case.

He concluded: "The directors are intelligent, experienced and conscientious people." They "acted as they did in good faith and believing that they were discharging their duties properly".

He also commented positively on the fact that the directors "took immediate steps to investigate and inform the market as soon as they were aware" of an issue with the accounts.

Justice Middleton ordered each of the defendants in the proceedings to pay a proportion of the plaintiff's costs. He rejected the Australian Securities and Investments Commission's call for penalties and disqualification orders to be imposed on each of the non-executive directors, finding that the orders proposed were "sufficient for general deterrence".

He held that because the NEDs "were and remain men with valuable experience and skills of benefit to the public", more punitive penalties for the directors, such as disqualification, would be "unnecessary and excessive" and "would not be in the public interest".

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## Preparing for new personal property laws

A radical overhaul of personal property laws means that businesses supplying goods on credit must record their interest in the goods on a new national Personal Property Securities Register (PPSR) or risk losing assets to competing creditors should their customers become insolvent, warns Daniel Turk, commercial law partner with TurksLegal.

According to Turk, the PPSR, which is expected to commence on 31 October this year, permits registration of security interests in all kinds of personal assets and will replace state and territory registers of encumbered vehicles, as well as various Federal registers including the Australian Securities and Investments Commission Register of Company Charges. Personal assets include items such as trading stock, furniture, jewellery, cars, business equipment, livestock and contractual rights and intellectual property.

Turk says businesses supplying goods on credit terms subject to retention of title (ROT) clauses are at particular risk of being caught out by the new laws. ROT clauses are common contractual provisions that prevent ownership of goods from passing to purchasers until the supplier is paid in full.

"Prior to the new personal property securities legislation, ROT clauses alone were generally enough to protect a supplier's ownership of unpaid goods. If the customer went under, the liquidator, receiver or administrator was largely bound to pay out the supplier if the stock was sold on a winding up, receivership or administration," says Turk.

"From October, all that will change. Businesses that do not to take additional steps to register their ROT interests on the PPSR could lose out to competing creditors with registered interests. In most cases, this will be the customer's bank which typically has a charge over all the customer's stock and assets as security for its business loans."

Turk notes that with corporate insolvencies sky rocketing, suppliers have a heightened exposure in the current climate. Total external administrations for June 2011 are up 25.7 per cent to 1,027 – the second highest on record. Only March 2009 recorded more company insolvencies with 1,095.

"In this environment, prompt registration is crucial," he says. "To protect their interests, suppliers of goods should review their terms of trade without delay. For new customers, terms containing ROT clauses should be in writing, signed by the purchaser and registered on the PPSR before the goods are supplied.

"In the case of existing customers, there's a two-year transition period to get interests registered, but it will not apply in all cases so

companies should not assume they are eligible. There are traps to watch out for. For instance, if your existing terms are sale by sale agreements, you will not have transitional protection."

Turk says while the new legislation has been expected for some time, companies continue to underestimate the significant risks to their business of failing to set up new documentation and systems.

"Similar legislation has been on foot in New Zealand for some time. In the administration of Borders Bookstores in New Zealand, in assessing the claims of retention of title creditors, the administrators distinguished those creditors who were registered with the PPSR from those that had not registered."

In view of the serious financial implications of the PPSR, Turk says directors should urge management to thoroughly review the company's terms of trade to ensure the company is in the strongest possible position to protect its ownership interests in the event of a customer's insolvency.

The board should also ensure the company has appropriate procedures to register new customers and to review and migrate existing customers to the PPSR in a timely way. "This may mean ensuring there are appropriate notification triggers and communication channels between sales and compliance or legal staff," he says.

Given the dramatic changes introduced by the new regime, Turk says directors should also ensure the company invests in training for key staff on the effect of the new laws and registration requirements.

He says questions directors should ask of management include:

- Does the *Personal Property Securities Act 2009* (PPS Act) affect our trading terms?
- Have you considered whether our customers need to be registered on the PPSR?
- What processes are in place to register new clients on an account being opened?
- What is being done about registering existing clients?
- Are our terms of trade sufficient to obtain a registrable interest under the PPS Act?
- Do our terms of trade minimise our compliance obligations by excluding (where permissible) various customer and third party notification provisions in the PPS Act?

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## The importance of employee engagement

Directors and senior management of all organisations, large or small, should show their disengaged employees the door. "Set them free, let them go and work for your competitors!"

That was the advice from Naomi Simson, chief experience officer of online experience gift store RedBalloon, at a *Leaders Edge Lunch* in Perth recently.

According to the *Australian Gallup Biannual Australian Engagement Study* (2008), around 21 per cent of employees are actively disengaged across Australia, costing businesses up to \$42 billion per year in lost productivity.

In contrast, RedBalloon boasts a 97 per cent employee engagement score (by Hewitt Associates 2008), whereas the Australian average is 54 per cent. RedBalloon is also ranked 29th by *BRW* and The Great Place to Work Institute's annual list 2011. It ranked ninth in 2009 and aims to pip Google for the number one position in the future.

Simson noted that disengagement meant that the employee was not present or focused on the immediate task, nor contributing to the goals of the organisation. She added that the Gallup study indicated that 24 per cent of disengaged employees intended to spend their entire career with their current organisations.

Simson warned against expecting money to engage employees. "If you give them carrots for sales, next year they will want more carrots for the same level of sales," she said, noting that no amount of money would keep employees in a role they were not connected to.

When asked how she engaged with different generations of staff, especially Gen Y, she highlighted that the language used in the question as a problem in itself, explaining that she never referred to anyone within the company as staff. They were RedBallooners, colleagues, the team.

Simson also touched on the culture change that is needed to allow men, as well as women, to work flexibly and be part of family life, noting the few companies who do encourage males to work part-time or flexibly have little uptake of the offer due to the perceived negative impressions it may produce.

But she believed directors could help in changing this culture. "There was a man called Ghandi who sat down and didn't eat until he changed India," she said.

Simson provides the following tips on how to improve employee engagement:

**Earn Trust:** Leadership needs to earn trust consistently and a great way to do that is to simply notice what people contribute.

**Change your culture and focus on non-financial rewards:** Simson recommends reading Daniel Pink's book *Drive*. He outlines how cash rewards cause long-term disincentive and reduced creativity. She says: "Ask your employees what they want as a reward. More money is rarely top of the list. Loyalty is rarely about the money. Notice people, love them, value their contribution and make them heroes – make their dreams come true and they will be with you forever – and will also give you their valuable discretionary effort."

**Make your values valuable:** Get clear on your values and recruit on them. "From the start, any new RedBallooners are pre-disposed to be attached to our organisation, simply because we know they share the values we stand for," says Simson.

**Read the *Little Red Book of Answers*:** It has 105 answers to topics such as creating motivated and productive staff, the power of employee engagement through to improving sales performance.

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