The Executive Remuneration Reporter

This Emerging Issues Note, Enter the Matrix, looks at the Board Skills Matrix recommended in the latest version of the ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations. Based on observations from the current 2015 AGM season (September to December 2015), it identifies some common problems and suggests an engagement strategy for investors to adopt with ASX listed entity Boards to improve the information contained in the Board Skills Matrix.

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Enter the Matrix

A new feature in corporate governance statements this AGM season is the Board Skills Matrix. Recommendation 2.2 of the 2014 version of the ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations states:

“A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.”

The brief commentary offers the following guidance:

- It’s a useful tool to help identify gaps in the collective skills of the Board and professional development initiatives for directors can help address the gaps. It’s also useful for succession planning.
- It’s useful information for investors: it increases Board accountability on such matters.
- The disclosure need only be made collectively across the entire Board as a whole. It does not need to identify the presence or absence of particular skills by a particular director.
- Commercially sensitive information can be excluded.

We include analysis of the Board skills matrix as background to the director election resolutions on AGM agenda. Having reviewed our first batch of companies, it’s worth comparing approaches we’ve seen because what we value in the disclosures doesn’t fit the guidance noted above. The issue may be with how director biographies are presented: many are too brief and lacking the details to match that director’s skills with the skills in the matrix.

Making disclosure collectively across the Board

Two different approaches are noted: one approach – an approach we prefer – is to identify the number of directors with the particular skill. Suncorp Group (ASX:SUN) adopts this approach in its matrix. Click on this link to see this example.

An alternative way to present the same information is used by Qantas Airways Limited (ASX:QAN), a simple table with a list of skills and the number of directors (there are 8 NEDs in total)².

Skills and experience

<table>
<thead>
<tr>
<th>Skills and experience</th>
<th>Number of NEDs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance expert</td>
<td>3</td>
</tr>
<tr>
<td>CFO/Accounting/Audit/ Banking</td>
<td>3</td>
</tr>
<tr>
<td>Accountancy</td>
<td>3</td>
</tr>
<tr>
<td>MAD/O/Marketing</td>
<td>5</td>
</tr>
<tr>
<td>Engineering/ndustrial</td>
<td>3</td>
</tr>
<tr>
<td>Current or Former CEO (or equivalent) of a listed company</td>
<td>4</td>
</tr>
<tr>
<td>Licensed to Practise (LPA) for equivalent of a non-listed company</td>
<td>4</td>
</tr>
<tr>
<td>International Global</td>
<td>4</td>
</tr>
<tr>
<td>Security</td>
<td>7</td>
</tr>
<tr>
<td>Technology</td>
<td>4</td>
</tr>
<tr>
<td>Large-capital Projects</td>
<td>4</td>
</tr>
<tr>
<td>Mergers and Acquisitions</td>
<td>6</td>
</tr>
</tbody>
</table>

Other companies I’ve seen adopting this approach include CSL Limited (ASX:CSL),³ Orora Limited (ASX:ORA),⁴ and Insurance Australia Group Limited (ASX:IAG).⁵

What’s the advantages of having the numbers?

It allows you to see if there is a balanced representation of the essential skills for that particular listed entity. When I look at a Board Skills Matrix I put the generic management/NED skills to one side and focus on the more unique attributes.⁶ Take the Qantas example above: 6 of the 8 NEDs have mergers and acquisitions experience...but how frequently has this experience been called on at Qantas since the attempt to take Qantas private back in 2006-2007? Three of the 8 NEDs have aviation industry experience while 5 of the 8 have FMCG/marketing experience.

Labelling the skills

The skills ‘International Global’ in Qantas’ skills matrix above prompts the question: what does it mean?

A challenge for Boards is to label each skill so they can be readily understood. The more precise the label, the easier it is to identify the not only the relevant skill, but also the directors with that skill.

Qantas does this with ‘Finance Expert’, defining it as someone who has a background as a CFO or else a background in Accounting/Auditing or Banking. The label used at Orora is ‘financial management’ and 6 out of 6 directors have this skill. Suncorp uses the label ‘Financial acumen’ and 9 of 9 directors have this skill (Suncorp’s Board has 8 NEDs plus the MD/CEO). Reading through the biographies for these directors indicates the skill they’ve identified is not the same as that identified by Qantas.

ASX Limited (ASX:ASX) includes ‘Financial acumen’ as a skill, defining it has ‘accounting and reporting, corporate finance and internal controls, including assessing quality of financial controls.’⁷ While ASX doesn’t use numbers in its skills matrix, as defined it is a narrower skill than the way ‘financial acumen’ appears to be used at Suncorp. Per ASX’s view, financial acumen is the skill you expect to find in the CVs all the members of the audit committee.

Another example of fuzzy skills definition is ‘information technology’. Suncorp identifies that 5 of its 8 directors have this skill. Qantas has a skill ‘Technology’ and identifies 4 of its 8 directors have this skill. Orora doesn’t list this skill. ASX has a skill ‘Information/technology’ which it defines as ‘Use and governance of critical information technology infrastructure, digital disruption and information monetisation’. IAG has a skill of ‘Digital’ in its Board skills matrix, with 1 of its 9 directors having this skill. In a separate table of additional competencies and experience, IAG includes the competency/experience ‘Strategic IT’ with 3 of its 9 directors possessing this competency/experience. Woolworths identifies ‘Technology’ and ‘Digital’ as separate skills.

In both instances – financial acumen or IT – being specific in skills description for the listed entity makes it easier to identify whether you have the skill in the current bench or whether an additional NED with that skill should be recruited.

Skill, experience or attribute?

AGL Energy’s 2015 Corporate Governance Statement notes the Board has revised its skills matrix and has identified a set of skills new appointees should have.⁸ It includes ‘experience in consumer markets with an understanding of customer behaviours in an increasingly digital world’, and ‘experience from an industry that has been materially disrupted or transformed by the emergence of new technologies.’

This raises the issue of what do we mean by ‘skill’? As Shinichi Suzuki says, ‘Knowledge is not skill. Knowledge plus ten thousand times is skill.’
If you accept this definition – skill is acquired from experience – a training program for directors cannot give skill. It can give knowledge and perhaps some insight, but it cannot adequately impart a skill.

There is also a distinction between experience and skill.

Direct industry experience is a good example of a characteristic you want some of the directors on the Board to possess. A director could have industry experience in consumer retail but have a finance background or a legal or human resources background. These directors will have relevant industry knowledge, but not the skills that come with the experience of having supply chain or inventory management on the CV, or being the general manager in charge of a large and successful consumer retail business.

Of course for some industries, having a NED with financial experience directly in the industry matters. Usually a call for more NEDs with industry experience is for NEDs with the skills that come only from the experience of doing retail, or financial services, or mining.

Some Boards are clearer on skills than others. Take the IT example: what skills do you need the individual non-executive director to have? If information technology is being able to make sound strategic decisions on IT investment, then there are a variety of different roles where that skill could have been developed. If, however, the skill required is able to successfully implement digital technologies in a consumer-focused environment, the individual NED will need to have different, and recent, experience in particular roles, in particular industries.

Suncorp’s Board Skills matrix includes the skill of 'Customer Data Insights and Big Data'. It links directly with a new aspect of its Learner, Faster, Smarter strategy. With better business intelligence and its Optimised Platform, Suncorp endeavours to anticipate customer needs and be first to market with new and innovative products and services. It’s marketing but requires some particular skills to have been acquired.

One of the more interesting skill descriptions I’ve seen included is ‘diversity’. An ability to successfully integrate different individual characteristics (gender, social, ethnic or cultural, religious) into corporate cultural life with demonstrated financial benefits is something quite different from having a goal of 30% female representation on the Board within three years. Most are reporting separately on diversity and while the company is happy to speak about broader diversity issues than gender amongst its workforce, the Board level diversity discussions I’ve seen focus solely on gender.

Enhancing Board appointments and renewal

Being able to drill down from the experiences and attributes: NEDs should have to the skills one could reasonably expect to come from that experience will better equip the Board to accurately assess its current bench strength and, where necessary, to recruit for specific skills. Yes: NEDs need to have certain attributes and experience, but they also need to have specific skills. I see the potential for better Board skills definition to lead to opportunities for new Board director candidates to emerge.

Being clear on the relevant skills also creates the opportunity to think laterally about suitable Board appointments. Go back to the Qantas Board Skills Matrix above: would having all NEDs with aviation experience be a better outcome than having some NEDs with this experience and other NEDs who have consumer marketing experience in industries other than aviation? Would Qantas’ Board benefit from having NEDs with Customer Data Insights and Big Data as opposed to just FMCG/marketing in whatever form that takes?

Woolworths separates out experience - retail markets experience is possessed by just over 50 per cent of its Board per the matrix - from skills - the skill of ‘operations’ is possessed by just over 75 per cent of its Board per the matrix so clearly that skill hasn’t been exclusively developed in retail markets. Does Woolworths need more operations experience obtained in retail markets and the skills that go with it, as opposed to ‘operations’ in any market?

1 A similar approach is adopted by Woolworths Limited (ASX: WOW) in its Board Skills Matrix. Woolworths Limited 2015 Corporate Governance Statement, p. 2.
2 Qantas 2015 Corporate Governance Statement, p. 2.
5 IAG 2015 Corporate Governance Statement, p. 5.

Engaging the Board on the Skills Matrix

If you believe investee company management matters, then engage with the Boards of your investee companies with a view to drilling down on the skills matrix:

- Ask for the numbers of NEDs who has the particular skill identified in the matrix: you might get a 7/7 report back but if all the directors possess all the skills then you might reasonably
- Ask for the details for the key skills: how is the Board defining ‘financial acumen’ or ‘IT’ or ‘operations’, because it may not match your understanding of what these skills mean in the particular investee company. In doing so,
  - Distinguish between industry experience and the skills derived from that experience and ask for a breakdown of the NEDs with the skills you believe necessary on the Board, given its industry and focus. And lastly,
  - Ask the Board whether the matrix reflects the world as is (highly likely if the matrix allocations numbers of directors to particular skills) and if there are any gaps between what is and what is best for the company, given its future strategic intentions.

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