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Authors(s)	Brennan, Niamh, Kirwan, Collette E., Redmond, John
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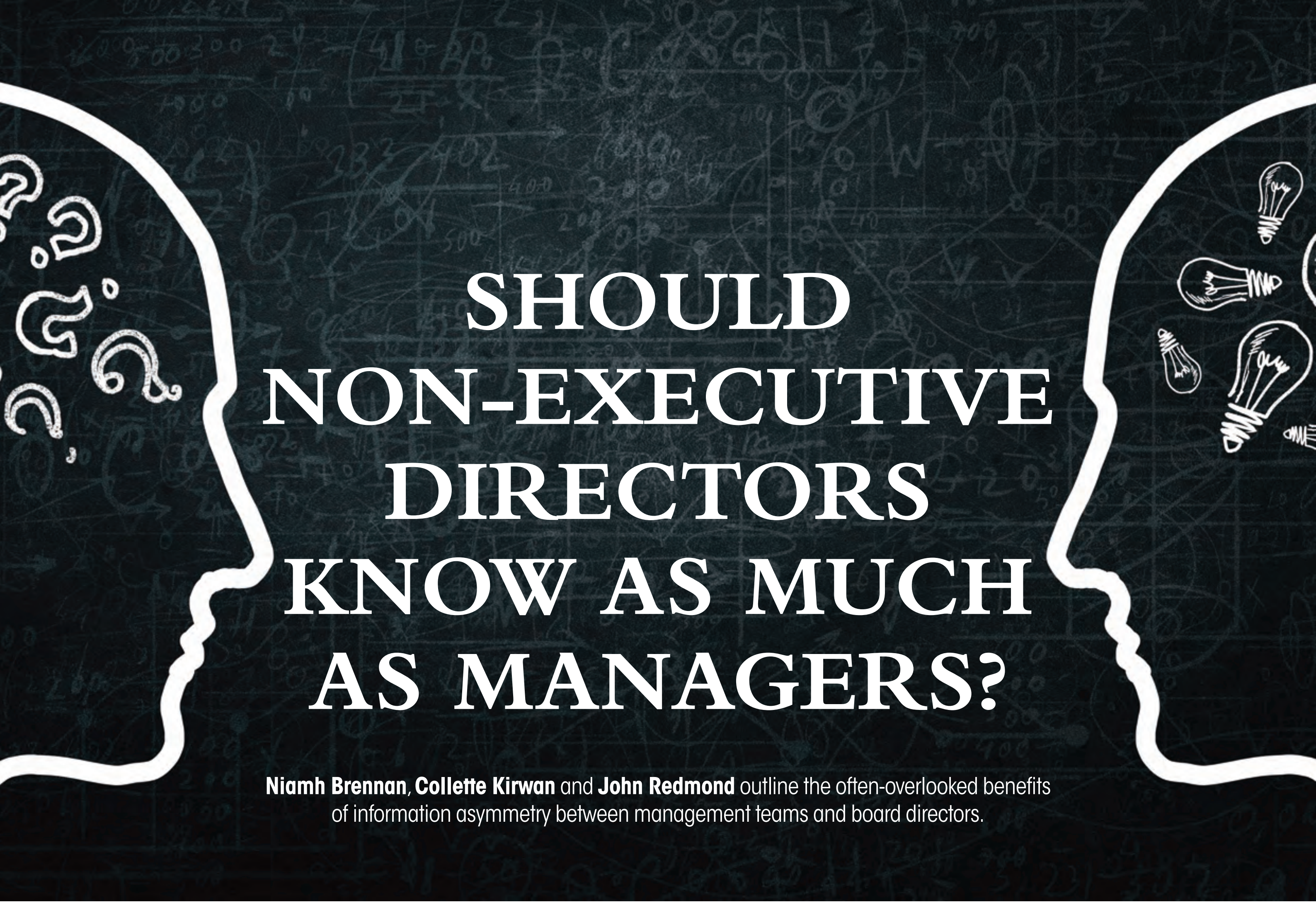

SHOULD NON-EXECUTIVE DIRECTORS KNOW AS MUCH AS MANAGERS?

Niamh Brennan, **Collette Kirwan** and **John Redmond** outline the often-overlooked benefits of information asymmetry between management teams and board directors.

Information asymmetry – the difference between company-specific information available to management and what is presented to boards – is often considered an impediment to board effectiveness. In some cases, governance failures arise because information is deliberately withheld from boards. Most boards work well, however, notwithstanding the information gap between managers and non-executive directors. Why is this so?

Paradoxically, it is by virtue of information asymmetry that non-executive directors can contribute to board meetings. Information asymmetry creates the context in which non-executive directors are expected to question and challenge managers. In other words, if there was no information asymmetry and non-executive directors had the full company-specific information available to managers, their contributions to the board would be limited. There would be no important question to ask at board meetings they could not answer themselves. Instead of acting as a barrier to effective board performance, information asymmetry is therefore a necessary condition for effective boardroom accountability. We call this the "information asymmetry paradox".

Notwithstanding the external knowledge and experiences that non-executive directors bring to the board, they do not have the detailed day-to-day information of business operations and/or detailed industry knowledge that managers have. Managers often complain that their board does not know enough about their business. Indeed, many consider boards incapable of carrying out their duties as they do not know as much about the business as management. This view is alarming, but becomes less so when board and management information are considered to be different, but complementary.

INFORMATION SETS

We arrive at our information asymmetry paradox by moving away from what is/is not known by managers and non-executive directors and, instead, by considering the nature of the information sets available to the two groups. Their different information sets allow non-executive directors to make a contribution. Table 1 contrasts the characteristics ascribed to managers by the 1970s management guru, Henry Mintzberg, with those characteristics generally attributed to boards and their way of operating derived from the Financial Reporting Council's *UK Corporate Governance Code* and related guidance. This leads us to differentiate managers' information as tacit or implicit and board information as primarily explicit.

The one complements the other. The tacit-explicit information distinction explains the differences and the interdependence between management and board information. Management information is primary and direct; board information is secondary and mediated. The stimulus-response directness in managers' information experience contrasts with more formal board experiences – rush hour compared with rules of the road, as illustrated in Table 1 (see right).

Former CEO of Barclays Bank, Martin Taylor, captured the stimulus-response directness in managers' information experience as follows: "[CEOs] need to act on the basis of dirty or incomplete knowledge, weighing risks and probabilities, and using intuition as much as deduction. The more senior the job, as a rule, the more uncertain the information on which you have to act. You don't have the luxury, for competitive reasons, of waiting for certainty". Based on our analysis in Table 1, the differences in the nature of management and board information are summarised in Table 2 (see right).

PRIMARY VS SECONDARY

The significant difference between management and board information is that

Table 1: Comparison of management and board work characteristics

Management characteristics

- Studies of chief executives suggest they seldom stop thinking about their jobs;
- Managers' activities are of brief duration of the order of… minutes for chief executives;
- Managers are seldom able or willing to spend much time on any one issue in any one session;
- To be superficial is… an occupational hazard of managerial work;
- Some of the manager's sources of information are open to no-one else;
- Managers work with verbal information and intuitive (non-explicit) processes; and
- The manager demonstrates a strong thirst for current information.

Board characteristics

- The time devoted to the company's affairs is likely to be significantly less for a non-executive director than for an executive director;
- The chairman should ensure that adequate time is available for discussion;
- Issues brought to the board should be given thorough consideration;
- The non-executive director should insist on full and satisfactory answers within the collegiate environment of the board;
- The emphasis in all information… should be on clarity and transparency;
- For significant decisions, a board may wish to consider extra steps, for example, describing in board papers the process… to arrive at and challenge the proposal; and
- Information must be provided sufficiently in advance of meetings to enable non-executive directors to give issues thorough consideration and must be relevant, significant and clear.

Table 2: Management and board information

Management information	Board information
• Intuitive;	• Reflective;
• Implicit;	• Explicit;
• Spoken;	• Written;
• Individual;	• Collective;
• Informal; and	• Formal; and
• Expert.	• Generalist.

management information is based on primary, direct experience. It is often incommunicable and ambiguous. Board information, on the other hand, is derived from secondary sources such as papers, reports and presentations. Accepted guidelines suggest that, to be effective, board information should be high quality, relevant and clear. It should be distributed in a timely manner to allow non-executive directors thoroughly consider the issues in advance of the meeting.

The difference between managerial and board information is the difference between originating or initiating the information and receiving or formally processing that information. This view of management as originators and board members as recipients of information or knowledge may provide a framework for resolving the information asymmetry paradox. The difference between the live, primary and personal information of management and the processed and collective information of boards is essentially the difference between implicit/tacit and explicit information.

The importance of tacit/implicit information has also been acknowledged in the 2009 UK Walker Review following the banking crisis. It states: "The chairman, EDs and NEDs need to be experts in the ability to observe, interpret and draw conclusions about what people are giving clues about, but not talking about: that is, interpreting what lies just below the surface".

A NECESSARY CONDITION

The paradox is that information asymmetry is necessary for effective boards. By engaging with boards, managers are required to account for their actions and to make explicit what otherwise would be implicit and inaccessible. Information asymmetry between boards and management is a fact. Management has more company-specific information. Boards depend on management for much of their information. We must accept these realities of individual experience and group dynamics as we find them, rather than seek to invent an idealised governance process. Some commentators, however, have adopted a different approach. They regard information asymmetry as a threat to board effectiveness.

Accountability, involving the process of transition from the individual judgements of managers to the collective judgements of boards, is the real manager-non-executive director information dynamic. For some commentators, to be truly effective, directors should overcome information asymmetry so that they will have a firm grasp of the business and its risks. However, any demand for information equivalence between boards and management fails to recognise that much of the valuable information in organisations is specific to individuals, is tacit, and is not readily communicable.

CONCLUSION

It is important to understand the distinction between the different information sets available to managers and non-executive directors when deciding on board composition and processes. Understanding the distinction may assist in establishing and assessing information-sharing processes and assist in the induction, education and ongoing development of managers, non-executive directors and chairpersons. The two distinct information streams join in a common outcome and a shared judgement, as expressed in the time-honoured minute of decision: "It was resolved…".


Prof Niamh Brennan is the Michael MacCormac Professor of Management at UCD.


Dr Collette Kirwan is a Lecturer in Accounting at UCD.


John Redmond is Company Secretary of the Electricity Supply Board (ESB).