Board-led transformation

AN AIRPORT CASE STUDY

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▶ Strategic renewal requires a board ready to drive a vision for change.

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Almost all boards confront a number of common obstacles to continued success. One of the biggest challenges is to develop a robust and enduring process of adding value to organisational growth. For some boards, it can be tempting to ratify and monitor strategic renewal initiatives generated by senior management with an eye to fine-tuning efficiencies. For others, a lack of clarity about the need to formulate and implement new growth stalls strategic decision making. In either scenario, the board puts long-term organisational survival at risk.

GIVEN THAT strategic transformation is often disruptive, risky, and costly, it is not surprising that directors of boards often find themselves governing companies that are chained to the status quo.

Strategic renewal requires the board to break the status quo and lead change by establishing a vision, and advocating new directions among directors, and with senior management, and stakeholders. The recent experience of Auckland International Airport illustrates what can be achieved.

With growth stalled by the constraints of relying on local passenger demand and airline carriers served, Auckland International Airport (AIA) sought to reposition itself as a lead partner in the tourism industry as 'the gateway to New Zealand'. Not content to remain an infrastructure provider, AIA set out to rewrite the playbook for airports. It spurred creativity and innovation, boosted the wealth of shareholders, and re-established competition among carriers. It diversified and positioned itself among the top dozen airports in the world, as recognised by the Skytrax World Airport Awards. By December 2015, AIA earned top spot on the New Zealand Exchange as the largest listed company, with a market capitalisation of $6.85 billion.

The success of AIA is not easily explained if one uses conventional thinking about corporate governance. Its rise cannot be attributed to the usual suspects – board composition, size, the separation between chair and CEO. These structural features simply cannot account for how the board became a competitive advantage for AIA. The company's transformation raises a critical question: How is board leadership exercised to enable strategic transformation?

The research team investigated the transformation of AIA between 2007 and 2015 as part of a larger leadership and governance research project (see sidebar). To deepen our understanding of the board's contribution to strategic decision making, we engaged in a longitudinal study exploring governance and leadership processes aimed at embedding sustained value creation. Given the board's potential to help shape strategic transformation, we looked in particular at its relationships with senior management, shareholders, and stakeholders, and among directors.

Recent local and global corporate failures have propelled board leadership to the forefront of the research agenda and they carry practical lessons for current and aspiring directors. While corporate decision-making responsibility lies with the board, governance theory has tended to assign it an oversight role in constraining managerial misbehaviour and misconduct and maximising shareholder wealth. The preoccupation with reducing agency cost has overshadowed the comprehensive role the board plays in initiating and implementing strategy – despite the legal duties of directors suggesting that a purely passive approach to governing is untenable.

Boards that do not critically reflected on the longevity of their strategies and their current relevance for growth may find their capacity to adapt eroded as circumstances change. New markets rarely start out at full scale, or with clearly identified needs. Like most new initiatives, they start out messy and uncertain. Nevertheless, they are not the exclusive territory of small new firms; there are ways in which large, established companies – such as AIA – can create the type of transformation that secures competitive advantage.

Faced with the need to mitigate risk, it is understandable why a board might decide not to pursue transformation, even though the long-term potential for reward is attractive. But left unchecked, a penchant for risk avoidance can foster a sluggish, relatively stagnant organisation that is vulnerable to the market actions of agile competitors.

Boards committed to strategic renewal, adaptation, and growth may benefit from three leadership-in-governance process insights: opportunity exploration, strategic selection, and mobilisation. Much like a triangle, all three enablers affect each other's development iteratively. With each of the processes taking centre stage at different times in the transformation, board leadership determines which one exerts strong influence while the others act as support.

LEADERSHIP INSIGHT:
ENGAGE IN OPPORTUNITY EXPLORATION

In this process, board leadership creates the relationship among directors, with senior management, and between shareholders and stakeholders to continually pose and consider options for positioning the company where

opportunities are most promising. The conventional approach – firmly etched in the practice of many boards – in which the CEO devises strategy and the board approves or holds out for changes, is eclipsed by these processes. For the approach to succeed, it is essential for the board to learn quickly, stay alert to industry trends, and scrutinise the competition. These processes also involve cultivating creativity and openness, encouraging exploration, and fostering cooperation. This means that the board dynamic and the board-CEO relationship for strategy formation shifts from an orderly, predictable, and sequential (hierarchical) process to a dynamic, collaborative, and iterative one.

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AIA adopted opportunity exploration approaches in 2008 and 2012. In 2008 with the world-wide downturn in passenger travel, precipitated in part by the Global Financial Crisis, the earnings per share dropped by 63 per cent in one year, while total earnings before interest, taxation and depreciation shrank from $280 million in 2008 to $216 million in 2009. A first step in opportunity exploration came when the board recognised that its most promising future earnings and growth lay in re-imaging its core business. To initiate transformation, the board chose a CEO from outside the industry who had a track record in building effective management teams. Unencumbered by a conventional conception of what an airport company should do, the board and CEO took steps to envisage what this company could do. They quickly assessed AIA's strengths – managing the efficient large scale movement of people and goods between land and airside. They took into account changes in the wider industry and unprecedented global economic uncertainty.

A second step in opportunity exploration was to refuse to be deterred by ingrained assumptions about AIA's procedures, which had grown rigid through repetition over the 10 years since it listed on the New Zealand Exchange. Instead, they invited stakeholders to participate in shaping a new vision for AIA and were able to successfully reset the company's growth trajectory.

In 2012, with the planned succession of the incumbent CEO, and with four new directors and a different Chair, the board selected a CEO who forged relationships inside AIA, with the board, and among the tourism industry. These actions enabled AIA to capture the lion's share of the value accrued by having a flexible and responsive growth strategy. In both instances the board and the CEO collectively created a space for new ideas to emerge, encouraged open communication and constructive dissent, and promoted lively involvement.

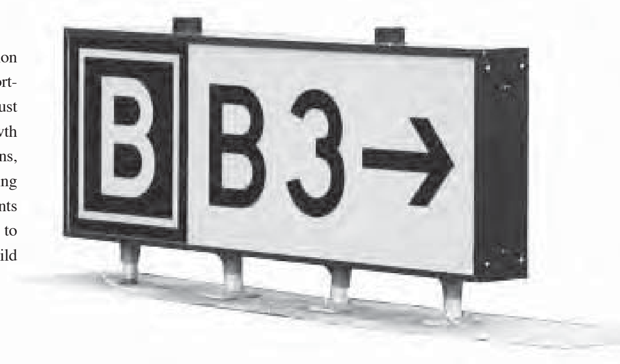
A third step in which board leadership shaped opportunity exploration processes featured dedicated strategy sessions. Annually, the board and CEO jointly selected which facets of the business – property, retail, technology, and so on – to investigate as a potential growth initiative. In this way, both the board and senior management shared responsibility for the strategic trajectory of AIA in both the short and longer term. For each of these sessions, directors and senior management were invited to suspend predetermined solutions and engage in discussion to explore strategic opportunities. Background papers, sent out in advance, added substance to discussions.

The fourth step was to ensure the diverse composition of the board itself, which evolved as the strategies and practices of AIA changed. The persistent focus on transformation and value creation led to a board that showcased a diversity of experiences, knowledge, skills, ideas, and perspectives along with remarkable networks.

LEADERSHIP INSIGHT: ENABLE STRATEGIC SELECTION

The second board leadership process is strategic selection, which involves aligning a distinct combination of value creating opportunities and reallocating resources to transform the business. The generation and acceptance of ideas for reallocation involve refocusing organisational energies and commitment to a shared desirable future state.

Because the outcome of strategic transformation cannot be fully predicted, it follows that short-term investor demands for immediate profit must be reconciled with a long-term strategic growth orientation. To deal with these contradictions, the AIA board pursued a mix of game-changing initiatives and incremental improvements anchored in a long-term strategic framework, to make the most of its existing assets and to build



new capabilities. First, passenger and retail services were overhauled, creating differentiation for travellers, and AIA also committed to improving efficiencies through real-time data collection shared among airlines, service providers and border agencies. The second initiative looked to capture growth opportunities from closely related businesses outside of the aeronautical industry, including accommodation, freight and logistics. The third featured more organic or opportunistic possibilities beyond the conventional airport business, and included overcoming the conventional limitations of the physical location.

The strategic framework provided enough flexibility for the board to examine, explore, challenge, and ultimately choose which options to pursue without being prescriptive. It also accelerated decision making as emergent opportunities became known, such as the prospect of acquiring a stake in two North Queensland airports (MacKay and Cairns) and the airport at Queenstown.

Coupled with the large-scale opportunities, the board also opted for small-scale trials to assess the potential for larger-scale adoption. One result was the development of the Novotel and Ibis hotels on the AIA's 607ha site. Following the success of this business venture, a third hotel was slotted into the design phase. The small trial approach also extended to the creation of a business park on non-aeronautical land that tapped an unmet demand from a range of businesses, including Coco-Cola, Amatil, and Fuji Xerox. This proactive experimentation lowered the perceived barrier to both conventional and unconventional initiatives, with success attracting additional support and investment for wider roll out.

LEADERSHIP INSIGHT:
ENABLE MOBILISATION

The third process is to enable mobilisation. Successful board leadership in this area favours continuous engagement by building new relationships and maintaining existing ones. Expressing a sincere interest in the opinions of others, and seeking similarities, fosters a shared purpose and a supportive climate. All too often boards do the opposite, taking a sporadic interest in perfunctory assessments of strategic performance, and signaling to shareholders and senior management when corrective action is needed.

Among the AIA board of directors, the challenge was as much about understanding and strengthening the relationships that shape its assets and processes as it was of jettisoning outmoded processes and policies that impeded growth. In its aviation business, the board redefined its stakeholders to include new airlines and new routes.

At a time of flat growth in passenger numbers, the board and CEO drew on their relationships within the company and across the industry to cultivate new route development with China Southern Airlines, the world's third-largest airline. To maximise success, the board and CEO jointly identified the requisite candidate capabilities and behaviours for the role, and where to recruit talent for a dedicated route development team. The initiative paid off.

The inaugural flight, welcomed by the Prime Minister and Minister of Tourism, triggered long-term growth for AIA with this airline and initiated new relationships with other carriers.

Perhaps one of the most profound challenges of board leadership involves enabling mobilisation among and between directors. For AIA this challenge emerged during the election results at the 2007 annual general meeting. Three new directors, chosen by block shareholders rather than the board, were appointed to the board. At that time, the prospect of refusing to cooperate with new directors could have fractured the board, impeding decision making as analysts speculated.

However, things turned out rather differently. With a 50 per cent change in board membership, incumbent and freshly elected directors began a long, steady process to build trust within the board anew. Any lingering doubts about the appointments were shed as the board found common ground in individual and collective commitment to AIA’s goals. Confronted with the new reality of overseeing the operation of a Crown-declared "sensitive asset" in which foreign block ownership was prohibited, they focused on putting in place the systems and processes needed for AIA to adapt to its new found status.

Guided by a shared vision for AIA, the board challenged management’s perspective as well as that of other directors, to identify opportunities and network with government, shareholders, and other stakeholders.

AN EYE ON THE FUTURE

For organisations to thrive and evolve, board leadership is needed to instil a capacity for adaptation. When it comes to strategic renewal, such leadership plays a critical role in both what is done and how it is achieved. The creation and adjustment of strategies to position a company for long-term value creation appears to be a collective endeavour; one that benefits from engagement with individual directors, management, shareholders and stakeholders.

Positioned at the intersection of different, sometimes conflicting perspectives, the board mediates among these relationships to create an integrated strategic direction for long-term growth, employing the interactive processes of opportunity exploration, strategic selection, and mobilisation to bring about transformation.

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IMPLICATIONS FOR DIRECTORS

The research reveals that strategy needs to continuously evolve as the competitive landscape changes with technological innovation, new entrants, and different services and products. Boards must be able to foster a team approach which supports and questions proposals when they are made, inspires new ideas and direction when obstacles are encountered, exemplifies valued behaviour, and adapts individual coaching and mentoring.

Achieving ideal board dynamics requires moving from an individualised notion of leadership to a collective approach that involves a contested and negotiated set of relationships. The impact of board leadership for strategic transformation goes well beyond the motivating effect of an inspirational leader. It bridges conflicting perspectives to reposition the company so that significant growth and wealth creation can occur. Fostering such a transformation requires board leadership that guides decisions and actions to help build a shared vision as well as influence organisational design and allocation of resources. The payoff is an active and engaged board committed to successfully formulating and implementing strategy.

ABOUT THE RESEARCH

For the Auckland International Airport board study, the researchers interviewed all three board chairs appointed between 2007 and 2015, six current and former directors and a CEO. They also reviewed a range of business publications, internet sources, and publicly available corporate material. The study is part of a larger leadership and governance research project led by Associate Professor Ljiljana Eraković. The researchers are working on a book, *Corporate Governance and Leadership: The Board as the Nexus of Leadership-in-Governance*, which is scheduled for publication in 2017.

RESEARCH TEAM

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Key take-outs

- Board leadership affects strategic decision-making for long-term value creation through enablers such as opportunity exploration, strategic selection, and mobilisation.
- Board leadership creates the governance relationships necessary to lift stock market performance.
- Board leadership fosters a dynamic balance between risk oversight and future growth and value creation.

Dr Monique Cikaliuk is a Research Fellow in the University of Auckland Business School's Department of Management and International Business. Her current research investigates leadership and governance processes that undermine or enhance board effectiveness in large, listed international companies, state-owned enterprises, and private firms.

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