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# Why good boards fail

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Board & Executive Assessment Solutions

*“Corporate Boards need to understand that the world has changed – what brought us success over the last 20 years will no longer work to help us survive and grow for the next 5 years.”*

Let's face it: The business landscape and economy have changed dramatically in the last 12 months and many believe it will never return to its heydays. Strong international competition, dropping legal and cultural entry barriers, rising geopolitical instability, the growth in unemployment, and the collapse of historical monopolistic practices – all of these elements indicate that any Board that chooses to ignore these changes or elects a “proactive wait and see strategy” is simply being unrealistic. Gone also are the days when being on a Board of Directors was seen primarily as a prestige position and supervisory role. Being a Board Member is now about active leadership, personal accountability and senior executive coaching rather than passive supervision. Board Members need to move from being reactive to dynamic by approaching their board work with increased vigour and dedication in order to make a positive difference to the organisations on whose boards they serve.

Boards need to reinvent their work on the fly whilst their companies face unprecedented change and challenges. Boards can make or break an organisation, and most Board Members now care substantially more about their personal reputation and the impact of being associated with an organisation that fails.

Boards are increasingly under pressure from regulators, shareholders, and stock markets to be held accountable for corporate performance. The global drive in governance standards has substantially raised the requirements for board performance, driving the rapid evolution of the role of Corporate Boards and Board Members. Investors are now openly stating their requirements for the appointment of high performing boards. Institutional investors are seeking reforms to enable them to elect independent non-executive directors to challenge the executive and hold them accountable for results.

Many Board Members have discreetly told me over the last few months that they are disgruntled with corporate governance speeches, events, elective codes, new rules and the constant complexities of ensuring their Boards and organisations comply. A Board Chairman recently told me “It's too much, too fast, and I spend too much time worrying about these complex corporate governance issues”. He added “can't this be boiled down into some simple practical practices and principles that could be easily implemented by our Board as a first step?”. This article is a pragmatic attempt to answer the Board Chairman's request by distilling ten simple boardroom principles for easy implementation. Based on personal boardroom and client experiences over the years, the failure to implement these principles is the main cause as to “Why Good Boards Fail”.

## 1 Principle 1: Board Mix

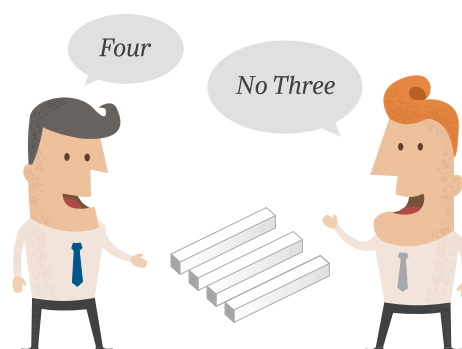
A Board of Directors is only as good as the individual Board Members who sit on the Board. Understanding the importance of the role whilst possessing the required skills, relevant qualifications and experience is fundamental to success.

Ensuring that Board Members have an appropriate mix of skills, competencies and characteristics is an important aspect of building a good Board and is critical for successful boardroom performance. In recent years, Boards have evolved into requiring more specialist skills in particular areas. For example, newspaper corporations have been actively seeking IT and multimedia expertise as their industry shifts more online. However, as well as having a specialised capability, Board Members also need broad competence and experience across a whole series of skill sets to fulfil their obligations as Board Members. This has implications for Board Director selection and the development of a robust Board Director Assessment Framework as it becomes more challenging to find that combination of specialist skills with the broad suite of experience. Increasingly, Boards need deep operational and industry skills with members who understand the complexity of the business.

*“A Board that truly adds value is not just a group of high performing individuals; A Good Board is a balanced team with complementary skill sets and a culture that allows them to work together to make the most effective decisions for an organisation. While the leadership from the chair is crucial, it is the full participation of every Board Member that contributes the most to the effectiveness of a board.”<sup>1</sup>*

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Reality can be so complex that equally valid observations from differing perspectives can appear to be contradictory.



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Furthermore, the Board's size and the structure of its committees will also have an impact on effectiveness. This calls for a Board Director Assessment Framework that encompasses leadership ability, business and industry know-how along with organisational cultural fit.

## 2 Principle 2: Board Members “Not Up To Date”

Board Members need access to the right information, at the right time, at the right level of detail in order to make the right decisions. The Board agenda and its associated Board papers form a substantial part of the information Boards Members receive to make those decisions.

The Board agenda will determine the issues to be discussed; this document is commonly assembled by the Chairman and the Corporate Secretary with input from the Executive. A Chairman would also typically offer Board Members the opportunity to suggest additional items as it is each Board Member’s responsibility to ensure that the right matters are tabled. The Chairman’s role in this is important to ensure the right agenda balance and further safeguard that the Executive is not overly controlling the Board’s agenda and possibly avoiding or reinforcing certain subjects.



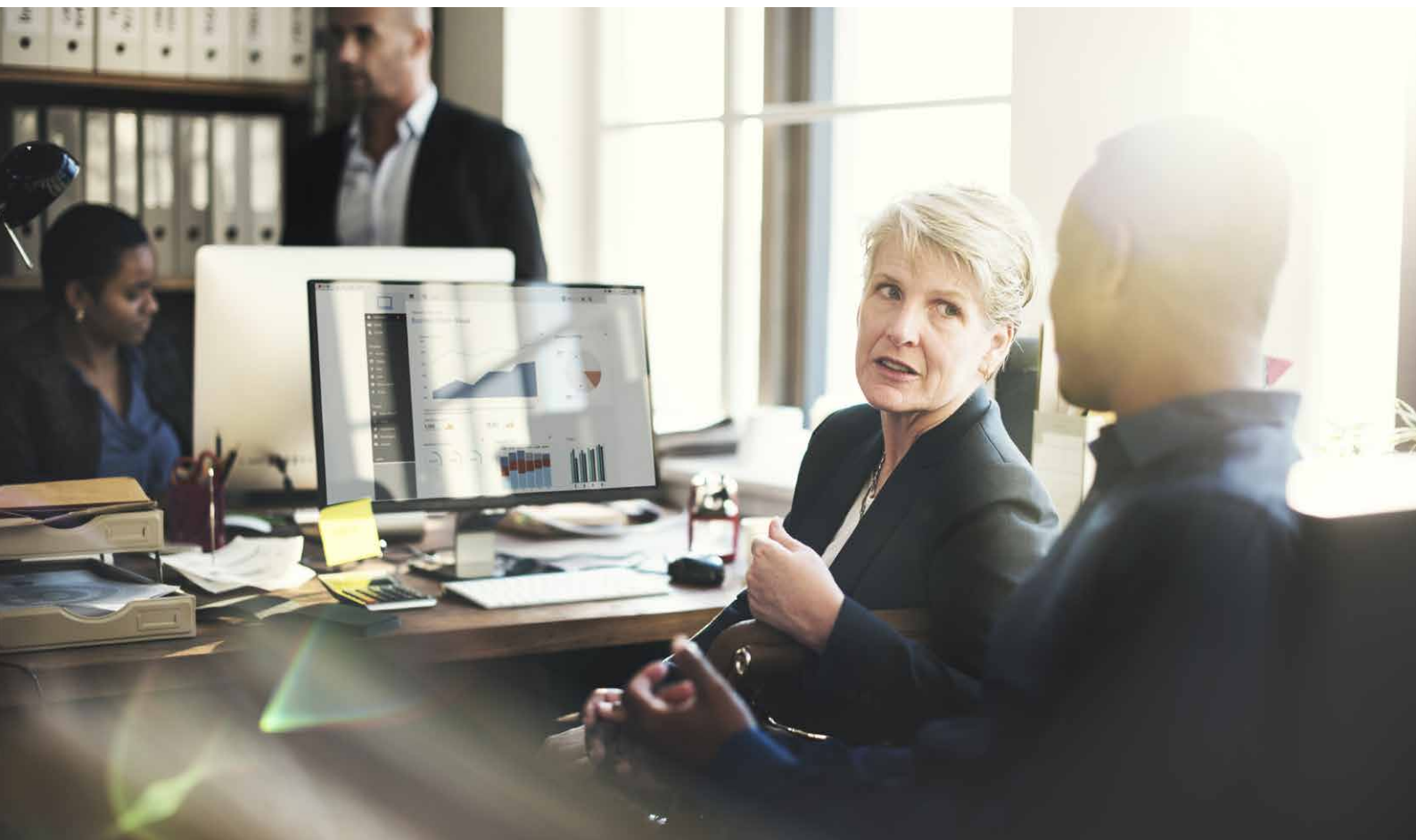
Board papers should be summarised and formatted in a standard structure so that Board Members can readily grasp and focus on the most significant issues during the Board meeting. The volume of information is not necessarily related to its quality or value. Less information, if structured and presented appropriately, may be better. Board papers should therefore be short, timely, concise, material and action focused.

I have worked extensively with one Board (Financial Services Industry) who requested that every Board paper presented by the Executive to the Board also include a final paragraph entitled “Recommended Board Resolution”. This recommended board resolution paragraph was to be written in a format that could be included in Board Minutes if the Board resolved to accept the recommendation. This not only crystallised the Executive’s recommendation in writing in one paragraph, but also allowed the Board to focus on the specific subject at hand.

## 3 Principle 3: Lack of Good Governance

Every corporation is unique. Understanding the corporation's constitution, both the "formal" and "informal" rules and the Board and organisational policies, procedures and protocols takes time. I have yet to serve on two Boards that are similar. Every Board and every corporation is substantially unique.

Attempting to follow practices and procedures you know from previous Board experiences may not fit the culture and environment of the next Board you sit on. In a one-on-one interview with a new Board Director of an Industrial/Construction Corporation, the leader described how he had historically taken the habit of walking around prior to Board meetings; informal chats, a quick coffee with the CFO, a couple of phrases exchanged with the COO, a brief conversation with receptionists. When he attempted this in a new, culturally-different organisation, he was finally taken aside by a fellow Board member who explained the cultural implications and the negative perception that his "constant spying" was having on the Executive. This was resolved by scheduling formal appointments, over coffee, and once the trust had been established, he received complaints from the individuals who he may have missed having coffee with at subsequent Board meetings. He did, however, learn a substantial amount about the organisation and its internal "rules" and workings which aided in making him a better Board Member.



# 4

## Principle 4: Poor Decisions

Board Members are responsible for making decisions in the best interest of the organisation whilst safeguarding corporate assets and organisational funds. Regular poor decision making is symptomatic of a dysfunctional Board. These Board characteristics, and recommended actions, include the following:

**A Wrong size:**

The Chairman should consider altering the board size by either requesting the nominations committee to initiate the selection and appointment processes, or taking appropriate steps to retire directors.

**B Insufficient range of expertise:**

The Chairman should consider requesting the Nominations Committee to initiate a study of the personal skills, knowledge, and attributes required by the Board. When carried out properly, this can easily identify skill gaps on the Board and paint the profile of the next Board Member to join the Board.

**C Inadequate information:**

The Chairman should ask the company Secretary and Executive to remedy the situation.

**D Inadequate debates, few overt disagreements or differences of opinion:**

The Chairman should consider encouraging non-executive directors to be more independent, challenging, and critical in their behaviour at Board meetings. It's a valued skill set to be able to disagree, without being disagreeable.

**E Decisions are made by small inner groups outside of the Board:**

The Chairman should consider reviewing the statement of reserved powers.

**F Few reviews to see if the decisions were correct:**

The Chairman should consider initiating a regular review of the Board's material decisions.

**G Failure to identify the risks:**

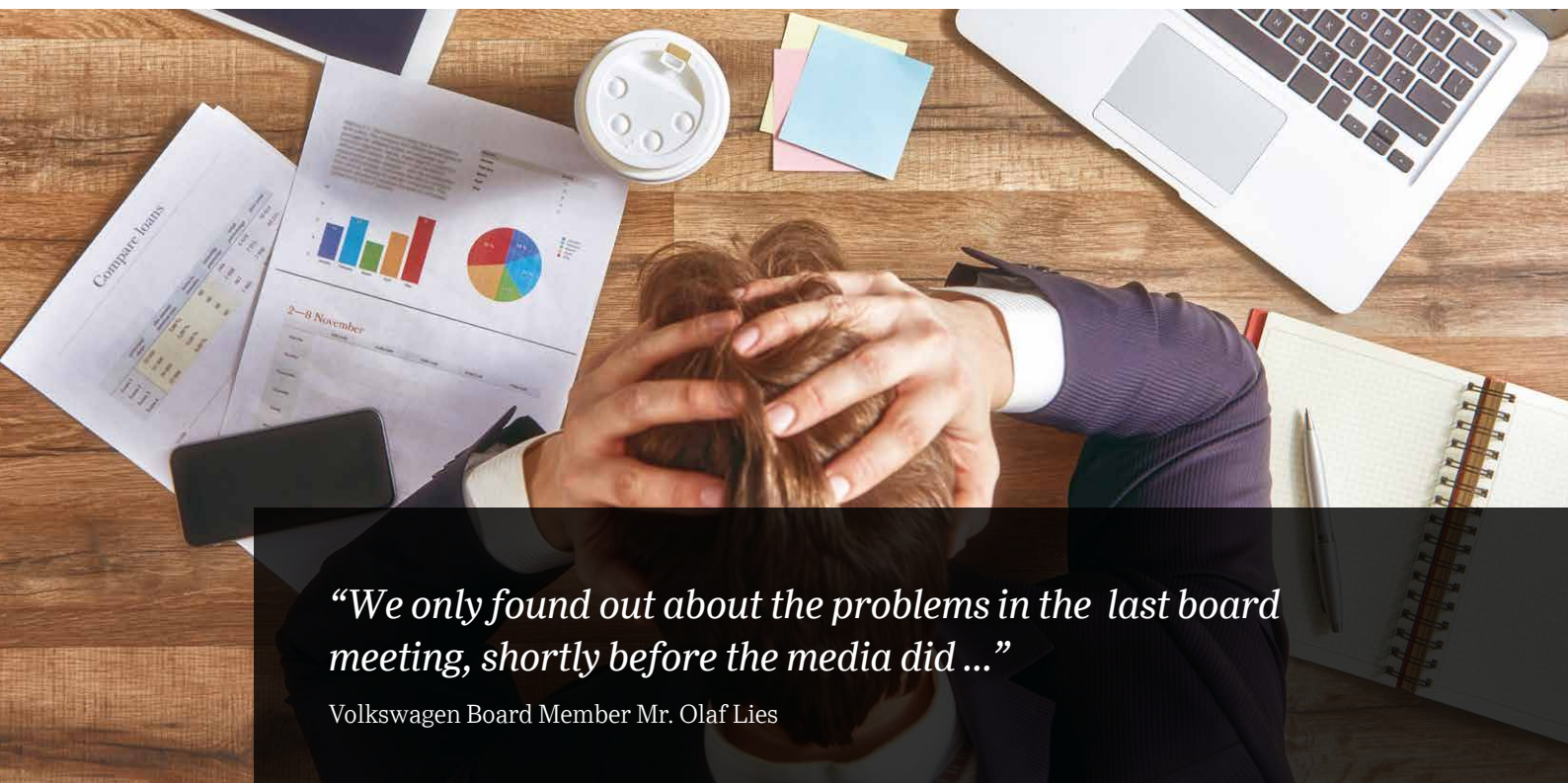
The Chairman should consider initiating a regular review of the organisation's risk profile.

In all the cases highlighted above, remedying Board dysfunction is the Chairman's responsibility, since the Chairman has ultimate responsibility for managing all aspects of Board meetings.<sup>2</sup>

# 5

## Principle 5: Risk Management

Germany's automobile sector accounted for 14% of the country's GDP in 2015 and Volkswagen, the largest vehicle manufacturer in the world, accounted for 1 in 4 cars sold in Europe. The company had been making its cars deliberately APPEAR less polluting than they actually were (40 times more polluting than permitted) and in September last year, U.S. authorities went public with the revelation that Volkswagen's cars had been deliberately cheating in emissions tests. With 11 million vehicles affected, fines and potential law suits, shareholders have seen some €20bn wiped off the company's value. A Volkswagen Board Director stated that "We only found out about the problems in the last board meeting, shortly before the media did ..." <sup>3</sup>



*"We only found out about the problems in the last board meeting, shortly before the media did ..."*

Volkswagen Board Member Mr. Olaf Lies

Unfortunately, just like ignorance of the rule of law excuses none from compliance, ignorance of corporate risks excuses no boards. Boards are the ultimate owners of the risks their organisations take to generate a return on investment for their shareholders.

I spent 10 years working for PricewaterhouseCoopers in their Global Risk Management Practice, working with Global boards. Risk Management was a relatively new concept that boards typically knew little about. Chief Risk Officers were and often continue to be Subject Matter Experts (SMEs) who find it difficult to synthesise complex risk management data into a form that is comprehensible by the Board. Few Board Members, other than Banking Board Members, understand Loss Given Defaults, Probability of Defaults, and Value at Risk or Risk Models.

The Board should request a regularly updated risk inventory, ranked by priority (impact and probability combination), and focused on the Top 20 Risks facing the organisation, along with recommended risk controls either in place or currently being implemented. One Board I worked with insisted on an Independent Audit of the corporate risk identification process so as to obtain comfort that the risks being shared by the Executives with the Board were all the risks the organisation was facing. As my work with this Board evolved along with the Board's Risk Management know-how and understanding, we culminated the exercise by defining the Board's annual evolving Risk Appetite in a visual chart. This allowed the Executive to measure major corporate risks against the Board's Risk Appetite and take the appropriate corrective/preventative action. As a Board Member, there is no excuse for not knowing that your organisation is taking a particular risk.

## 6 Principle 6: Misuse Of Assets

Assets and funds belong to the organisation and not the Board of Directors or the Executives. Acting as stewards on behalf of the shareholders, the Board needs to ensure that appropriate processes and controls are in place to manage conflicts of interest and the misuse of assets and funds.

One example of corporate governance enforcement carried out by the Dubai Financial Services Authority (DFSA) could be seen in the United Arab Emirates with Damas, an international jewellery retailer, which was publicly listed on the NASDAQ Dubai Exchange in 2008. In this case, the controlling shareholders and company founders carried out unauthorised withdrawals of corporate funds for a total value over \$160 million USD. The investigation conducted by the company's auditor found grave corporate governance failures: conflicts of interest at the level of the board, failure of the Audit Committee to meet, unauthorised use of company assets, inadequate segregation of duties and other issues. Following an extensive investigation, the DFSA proceeded to remove the Board, appoint senior executive staff and force the majority shareholders to make a full disclosure of assets. This investigation revealed serious corporate governance failures and the controlling shareholder was fined.<sup>4</sup>

Disclosure Note: I was the Chief Operating Officer of the DFSA at the time of this case and all information revealed here is in the public domain.





# 7

## Principle 7: Compliance

Companies need to comply with pertinent rules, laws and regulations. These should be recognised not only for the responsibilities and duties they impose, but also for the legal safety and entitlements obtained. The Board and its individual members are accountable for the corporation's adoption of and compliance with appropriate laws and any additional non-binding rules, codes and standards with which the corporation has chosen to adhere. The negative reputational impact of non-compliance with rules, laws and regulations is high and, as such, one of the core responsibilities of the Board is to ensure the Corporation's compliance.

### Practical compliance can be obtained by:

- A Identifying the applicable rules, laws and regulations.
- B Ensuring that the Board collectively understands all legal requirements.
- C Ensuring that the Board is kept up to date on evolving rules, laws and regulations, which can be achieved as part of a Board's continuing education program.
- D Ensuring that the Executive implements a comprehensive compliance and monitoring program.
- E Ensuring that regular compliance audit reports are included for review by the Board.
- F Including compliance checkpoints in operations as well as communicating and instilling ethical conduct into the Corporate modus operandi (Did anyone on Volkswagen Board understand that their ethical culture was conducive of deliberate cheating? - See "Principle (5): Risk Management)
- G Retaining a Compliance Officer responsible for establishing a compliance function.
- H Publicly disclosing how the corporation's compliance has been achieved, how effective it has been and any significant failures leading to penalties and lessons learned.

## 8 Principle 8: Financial Failure

Accidental or deliberate financial misreporting is one of the most common components in numerous recent corporate scandals. Whilst many cases of financial failure have involved either deliberate fraud or conflicts of interest, many other cases demonstrate a Board that merely failed to act on its oversight responsibilities. This financial negligence in the boardroom often results in substantial shareholder losses.



*An accounting scandal in 2014 at one of Saudi Arabia's largest telecommunications companies wiped out approximately \$380m in previous profits. The company revealed that it had misaccounted revenues and the corporation's share price slumped around 35 per cent in one month.<sup>5</sup>*

More recently, the troubled Saudi contractor Mohammed Al Mojl Group announced the resignation of its entire Board with immediate effect, days after the firm's Chairman Mohammad Al Mojl and his son were sentenced to five years in prison for misrepresenting the company's value. Saudi Arabia's Capital Market Authority's further banned a Big Four accountancy firm from providing accounting services in Saudi Arabia for two years, following its involvement with the company.<sup>6</sup>

Boards must ensure that they have the financial skills and expertise to understand all financial aspects of a corporation so that they may effectively discharge their responsibilities vis-à-vis the organisation's financial stewardship and accountability.

### A Board's financial oversight duties include:

- A Establishing Financial Controls
- B Ensuring Compliance with Financial Policies and Procedures
- C Approving an Annual Budget
- D Performance tracking (Actual Cash Flow, Expenses and Income vs. Budgeted)
- E Ensuring the long term Financial Sustainability
- F Defining Executive Compensation



### Typically, a Board also delegates their responsibilities to the Audit Committee for:

- A Overseeing the financial reporting and disclosure process.
- B Electing accounting policies and principles.
- C Overseeing the retention, performance and independence of external auditors.
- D Overseeing regulatory compliance, ethics, and whistle-blower requirements.
- E Overseeing the internal control process and reviewing the performance of the internal audit function.

## 9 Principle 9: Poor Direction / Strategy

The oversight of the development and implementation of a corporation's effective and sound business strategy is another core component of a Board's responsibilities. Many Board Members have commented that the only pragmatic manner for them to satisfy their corporate strategy responsibilities is to be actively engaged in governing the strategy process, without becoming operational.

I have witnessed one organisation (Financial Services sector) that included the development of its Strategy, Business Plan and Budget in a yearly 6-month cycle, starting with a short (10 pages) "Corporate Strategic Focus Document" coupled with an "Economic and Risk Overview Document". These re-focused the Board and Executive on the Corporate Vision, Current Strategy (what is working and what isn't), forecasted economic conditions in key markets and the risks currently facing the organisation. The final output of the process was a continuously adaptive business strategy, drilling down to divisional business plans and budgets, ratified by the Board in November for implementation in January. Regardless of the process, a well-developed corporate strategy should play to the organisation's strengths, mitigate risks and increase the chances of success.

Whilst there are many reasons why strategic plans fail, one the most common reasons is the inability of the Executive to translate strategy into implementation. A report entitled "Why Good Strategies Fail: Lessons for the C-Suite" published by The Economist Intelligence Unit in 2013, states, "The best-laid strategies of any organisation are useless without proper implementation ... In a survey conducted in March 2013, of which the majority of respondents were C-Suite executives, 61% of respondents acknowledge that their firms often struggle to bridge the gap between strategy formulation and its day-to-day implementation."<sup>7</sup> We can therefore conclude that whilst Boards need to ensure that their strategies are sound, they also need to ensure that they are implementable by their Executive Team.

*As markets change and evolve rapidly, an unwillingness to adapt ("we've always done it this way, so there's no need to ever change") can also be lethal...*

Boards can also display an unwillingness to adapt by remaining committed to a strategy that may have historically worked well. As markets change and evolve rapidly, this unwillingness to adapt ("we've always done it this way, so there's no need to ever change") can also be lethal: Polaroid Corporation refused to move into digital imaging until after this resistance to change had severely affected the company. By the time Polaroid finally accepted that it needed to adapt it was too late, and the corporation finally declared bankruptcy.<sup>8</sup>

## 10 Principle 10: Lack Of Teamwork

The Guidance on Board Effectiveness issued by the United Kingdom's Financial Reporting Council states, "An effective board should not necessarily be a comfortable place. Challenge, as well as teamwork, is an essential feature."<sup>9</sup>

Board Members should be appointed to the Board for their wisdom, strength of character and courage in making decisions and judgments concerning difficult and complex matters. It is therefore inevitable, essential, and healthy for boards to have a certain amount of tension, disagreement, and challenge. It is one of the most difficult responsibilities for a Chairman to manage those conflicts, disagreements, and creative tensions within the boardroom that may be negatively affecting the effectiveness of board meetings.

When Board Members feel comfortable around each other, they will feel free to speak their minds, unafraid of being criticized and opposed. Challenge and criticism will still occur and can't be avoided in a team of strong personalities, but they transpire within the limits of professionalism, not personal outbreaks. Over the years of working with Boards and conducting Board Assessments, I've often noted from experienced Board Members that it's not always "what they say" that is important but more often "how they say it", amplified by "what they don't say". Being able to respectfully disagree with a fellow Board Member without being disagreeable is an acquired and highly valuable skill set. Witnessing a Board that is capable, via conversation and disagreement, to reach a final consensus, is the fruit of a strong team. Research demonstrates that strong teams are built around mutual trust and respect and that a Board Chairman should actively seek to build a team spirit around the boardroom table.

Another experienced and retiring Chairman recently confided in me (during a Board Assessment mandate for an oil & gas company) that, based on his experience, "an effective boardroom team of good individuals is substantially better than an ineffective team of boardroom experts". He also highlighted the importance of "removing a rotten apple before the rot spread to the rest of the barrel".



## In Conclusion

As Boards come to terms with the changing economic conditions and the realisation of their “new” responsibilities, many are now exploring how to adapt and evolve. A Global Board Room Assessment Methodology, along with clear objectives, pragmatic tools and concise deliverables, allowing the Board to prioritise change and focus on what is required to be implemented in the next 12 months, is the equivalent of switching on bright lights in what was a very dark room.



*Boards now have their hands full for the foreseeable future adapting to new market realities, and Boards that do not proactively seize the opportunity to adapt may be in for a rough ride.*

Boards now have their hands full for the foreseeable future adapting to new market realities and Boards that do not proactively seize the opportunity to adapt may be in for a rough ride. The challenge is not just change but the speed of change, and the faster the pace of change, the harder the consequences of wilfully sticking to old ways. Those that seize the opportunity to strengthen and adapt their Boards earlier rather than later will find themselves more successfully positioned in the global marketplace.

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