

The Debate (Part II): Oversight vs. Complacency

There was an audible sigh of relief from some quarters as a result of my May article on oversight and micromanagement. “There you are, we shouldn’t interfere with what belongs to management. It makes for a dysfunctional company. We must give room for management to run the place; our job is oversight.”

It really isn’t very far from there to that clubby attitude which says that if all the numbers are okay, everything else must be. “Management is on the ball. They will tell us if there’s something to worry about.” The problem is that Management would rather fix something than tell you about it. That is their responsibility; but it sometimes means they will edit the information you receive to give themselves the room to do so. This means the clubby Board simply responds to what it is told.

Being reactive and being proactive are quite different, and so are the results. You don’t have to have a Boardroom filled with octogenarians, who nod off and require frequent toilet breaks, to be in danger of being caught unawares. You can have all the trappings of good governance as well, but forms of governance ultimately require people to make them work. When it comes to the Board, therefore, the most important determinant of effectiveness is the directors and how they behave. It’s not just the composition of the Board or its diversity, and it’s not just the skills, knowledge and experience of the directors. These are certainly important, but equally so are the personalities of the individual directors and the ways they apply the attributes they bring to the Board.

One thing that can blind-side a Board is bad data. A study conducted by PwC earlier this decade found that 75% of almost 600 companies interviewed had experienced some kind of financial pain because of inadequate data from one source or another. Only 37% of the companies were “very confident” of their own data, while only 15% were “very confident” of the quality of the data from their potential or existing business and trading partners. Poor data usually results in poor investment decisions, yet the same study found an alarming degree of complacency, with only 40% of Boards actually challenging what was put before them.

How can this be? There’s a tendency to follow the “rules of the club”, and one of those is not to make a noise in the Reading Room. The status quo, equilibrium, must be maintained. If a Board simply accepts data because it is provided by Management, it has relinquished ownership of that data and weakened its ability to influence the quality of that data. But the Board remains responsible for the decisions it makes, and those decisions flow from the processing of that data. So, asking out loud: “How good is this data; what have we done to verify this data; how valid are our assumptions; do we have a second opinion; what are the other options?” is not second-guessing management or micro-managing. It means making a noise in the Reading Room, and doing so for an important purpose – validating the basis of the decision the Board is being asked to make.

What these questions do, also, is open the way for directors to synthesise and analyse the data before them. Without such questions, why bother putting the brain in gear? But brains in neutral do not make well-informed decisions! And brains in neutral never challenge the status quo, especially if everyone is comfortable with it.

So, the next thing that can blind-side a Board is the enduring presence of positive outcomes. “Everything is going well, why should we delve too deeply?” Complacency thrives in these

circumstances. The focus is on the continuing delivery of value to shareholders, while ignoring the fact that every decision that leads to a positive outcome has a second side to it – the risks associated with achieving that outcome, and the consequences of not achieving that outcome.

It is complacency which encourages a Board to assume that the absence of bad news means all is well when it comes to operational controls and fraud prevention, cash flow management, asset protection, regulatory compliance and meeting disclosure requirements. And that's the easy stuff. With great results every quarter it appears to be self-evident that no additional validation is needed of the quality of corporate strategies. Why worry about market forces, environmental threats or the internal tensions that could lead to the destruction of value and corporate equity? That's all too negative; it means making a noise in the Reading Room.

We've looked at getting deceptive data from Management. Of course, if that is happening or the numbers are otherwise flawed, then the false sense of security leads to special discomfort for the Board. There have been several examples of that in recent times here in Malaysia. And the questions that seem to arise each time focus on why the Board did not question the numbers, especially the abnormalities, and why the Board was willing to accept numbers that painted a picture which was clearly at variance with what an ordinary shareholder would accept as a fair representation of the facts. By then, however, the whole world is watching closely and forming opinions based on what they see through an unforgiving eye.

Well before that stage is reached, though, what happens if the Board is getting accurate information, but it isn't the right information, or the Board is not processing that information adequately? Management will deliver what's required, but how can a Board get a picture of events which might destroy corporate equity if it focuses only on historic data? How can a Board analyse scenarios and attempt to measure likelihoods if it doesn't, first, establish a risk policy and clear risk tolerances, and monitor performance accordingly? It means getting risk on the agenda and keeping it there, even in the face of great performance. It means learning the language of risk, augmenting Board capabilities, and obtaining expert external opinion when clarity or additional expertise is needed.

It also means challenging the established business model. Is it sufficiently robust to meet the risk tolerances the Board has set? Has the world changed, or is the world showing signs of change in a way which could seriously stress the chosen model, and move the enterprise to an unacceptable risk scenario? Obviously, analysis must stop short of being excessive or obsessive, and the consequent paralysis of management, but it means making a noise in the Reading Room.

That has to be preferable to Directors having to defend themselves in front of shareholders, the media or regulators who believe they have been deliberately misled. It must be better than being accused of negligence in the decision making process and having the directors' individual reputation waste into oblivion along with corporate equity.

Keeping a quiet Reading Room can encourage many other dysfunctional situations. It leads to the toleration of a "bully" in the Boardroom, the dominating personality who silences all around him. He may be an aggressive CEO, or he may be a colleague so averse to risk that his presence effectively strangles corporate development and improvement. Either way, the

tendency is to agree and move on. “Yes Men” stay, while better directors drift away, frustrated that they cannot contribute.

Another norm of club behaviour is to promote camaraderie, not to mess up your colleagues’ sandpit. For instance, strained relationships between the Board and Management or between the Chairman and the CEO are never confronted. This can have damaging results, but life goes on as usual as far as directors are concerned, and that is the first priority.

Then there’s the incumbent who’s been there “forever”. He wouldn’t be offered a position on another Board, but he stays on because he used to be a contributor, or he’s a person of standing, or he’s well-connected in terms of business, politics or major shareholders. His “best before” date is long passed, but he’s still regarded as a benefit to the company. Indeed, even if there are term limits for directors, they are commonly waived for the sake of “face”.

This kind of Board loves its annual strategy retreat, where Directors listen to some eminent person talk about world economic issues but never attempt to link any of this highbrow analysis to the corporate realities for which they are responsible. This kind of Board will send Directors to seminars and to professional training sessions, but will refuse to engage in any discussion of Board development which threatens its composition or behaviour.

This kind of Board is a safe place for leaders who prefer to avoid issues. “If I wait long enough, maybe it will go away” is one type; “The cure could be worse than the disease” is another. Both imply a fear of change, a preference for the status quo. There is an unwillingness to examine even obvious Board failings and learn from them because of the worry that such a debate might upset the comfy equilibrium.

This kind of Board is also a happy place for the CEO with strong vision and drive, especially if he has a good track record. The Board will contentedly nod its approval while he whips the coach horses to a frantic gallop down a path no-one has travelled before, and in the absence of any understanding of what may lie ahead. The directors have been kidnapped, but do not appreciate that they are no longer passengers who can chose to alight when the journey becomes too frightening. In the recent past this has been the case with several monolithic financial empires. It left those Boards to wake one morning and find the world had changed in new and alarming ways, none of which had been contemplated, because quiet in the Reading Room was paramount. Maintaining that quiet also helped the same Boards subsequently approve huge bonus payments to those very executives who had been the principal architects of their misery, apparently ignorant of the attitudes of major investors, other stakeholders or the public.

Paradoxical it may be, but concentrating on maintaining the status quo is often the very thing which undermines it.

When I wrote last month about oversight and micromanagement, I spoke of a relationship of trust and mutual respect between the Board and Management, how both must understand their roles, and how each adds value to the enterprise. I spoke of “job descriptions” which define authorities, territory, contributions to the same issue, and how this document should set out the different roles in a way which clarifies the legitimate expectations of each side and leads to agreed deliverables.

It has to follow, therefore, that delivery is predicated on taking ownership of the allotted territory. It cannot mean relinquishing control of any element which helps sustain ownership of the territory, but that is exactly the situation Board complacency creates. Management is not necessarily interested in seizing control of the Board's territory; intelligent management wants a Board which fulfils its responsibilities and keeps control of its functions. The checks and balances are as valuable for Management as they are for the Board. However, Management is naturally focused on the complete success of the enterprise and, like Nature, will seek to fill a vacuum if one appears and threatens complete success.

Here's a suggestion on how to shake up complacency:

- Write job descriptions (with deliverables) for the Board and the committees, the Chair and the CEO, even for individual directors;
- Using the demands of the Board's job description, examine the spectrum of competencies required against those which exist in the present Board;
- Assess whether the elements of the existing Board, individuals and the committees, are delivering against the expectations established by the job description;
- Define short-comings and initiate programmes to upgrade Board effectiveness and performance, including education and confronting the uncomfortable;
- Create an idealised agenda which focuses on Board deliverables, and an idealised template for Board papers which contains information that supports the Board's ability to execute its agenda;
- Encourage all in the Boardroom to concentrate on issues, not just data, to get concerns on the table rather than having conversations in the corridor, to participate in debate and decision making, and to focus on support of the implementation process.

The Board has a real job of work to do. It's not the same as Management's job, but it's a job which needs to be done and can only be done by the Board. For instance, implementation and tactics follow policy and strategy; they do not dictate it. Defining an appetite for risk and monitoring it is different from managing risk. Succession planning for the enterprise is not the same as filling executive vacancies. No-one will relieve the Board of its responsibilities, so relinquishing control is not an option. It's another way of creating a dysfunctional enterprise.

I am in favour of active challenge and debate, learning and development for the Board and Management; they keep enterprises vibrant and healthy. Stay away from the Reading Room.

David Berry
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David Berry is Managing Director, Governance at Columbus Circle Governance Sdn Bhd, a professional firm offering services and advice in the areas of corporate governance, risk management and internal audit, investor relations, financial communications, strategy and issues management. He is a faculty member of Bank Negara Malaysia's Financial Institution Directors Education (FIDE) programme, Vice President of the Malaysian Institute of Corporate Governance and a Director of the Malaysian Investor Relations Association.

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