A Moral Compass

The board's conscience and commitment to do the right thing is a key approach to reducing board failures and scandals

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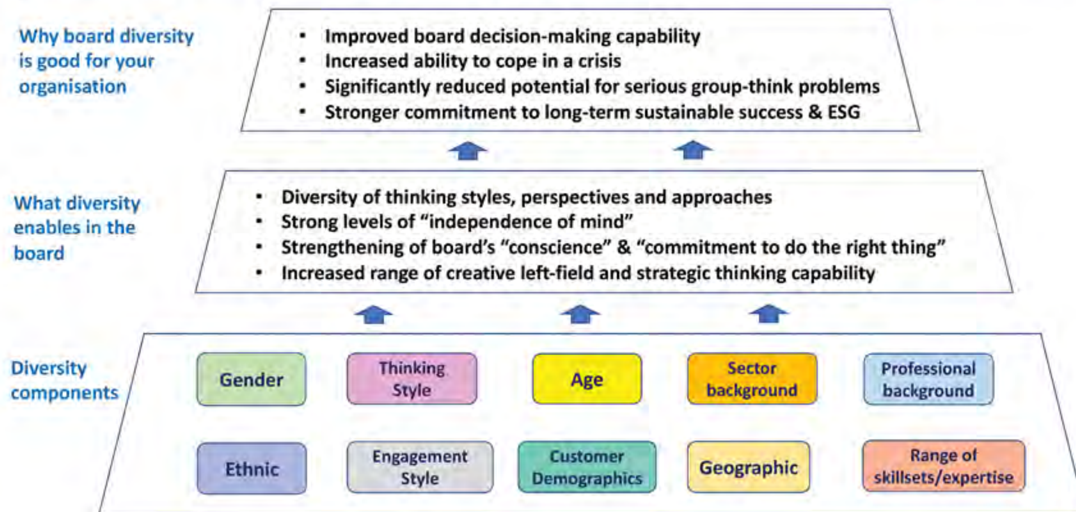
In the aftermath of board failures and scandals, such as Carillion and Wirecard in the corporate sector and their equivalents in the charity and non-profit sector, a 'groundhog-day pattern' ensues of the same questions being posed. How could this happen with such comprehensive governance codes, external audits and regulatory oversight in place? How could a board with such an experienced board chair and non-executive directors lose its way so badly? The sad reality is that for every high-profile board failure/scandal in the public domain, there are ten more board failures that do not make the headlines where the collective board of directors failed their shareholders and stakeholders. So why does this keep happening? Let's reflect for a moment on the typical types of board failures below. In reality, an individual board failure can span a number of these categories such as:

- financial fraud
- negligence, excessive risk-taking and mismanagement
- incompetence by board directors
- behavioural failures
- ethical failures.

In all these cases, the bottom line is that the board directors, individually and collectively, failed to discharge their duties and protect the interests of their stakeholders and shareholders. The standard reaction to these recurring scandals is to strengthen the governance codes, increase the level of regulatory supervision and to put such a level of 'belts and braces' around the board, so that it will be nigh on possible for the board to fail. On 18 March 2021, the Department for Business, Energy & Industrial Strategy launched a consultation on its proposals for wide-ranging reforms to modernise the UK's audit and corporate governance regime. The reforms proposed in the consultation would implement the recommendations of three previous independent reviews commissioned in the wake of a series of large-scale company failures, such as Carillion, Thomas Cook and BHS, which have been laid at the door of poor internal governance and external review at those companies. While improvements in the audit and corporate governance regime will always help, on their own they will not, in my view, radically reduce the number of board failures in the corporate sector as they cannot fully address the 'people factors' that are at the root of a significant number of board failures in the corporate sector, as well as board failures in charity and non-profit sectors.

In studying a significant number of the high-profile collapses in the UK, Ireland and internationally and in my own experience of evaluating boards and mediating board disputes, I believe that there is a very strong common denominator in these boards. The board's moral/ethical compass and failure to do the right thing can be caused by:

- arrogance, greed and hubris which suppresses the responsibility of the board and individual directors in the critical area of behaviours, culture, ethics and values
- a dominant CEO left unchecked by an independent board chair and non-executive directors who are either too close to or do not have the courage to stand up to a dominant and often bullying CEO
- a 'creeping group-think problem' caused by poor board diversity and a failure of the board chair in particular to instil a culture of the highest levels of challenge, debate, oversight and ensuring that the voice of the customers, employees, shareholders and broader stakeholders are properly present and respected in the boardroom
- poor standards of board chair leadership – in a significant number of board failures, the board chair failed. In our experience, the board chair has the greatest impact on a board's culture, effectiveness, governance and performance. The board chair is entrusted with a special responsibility by the shareholders and stakeholders to be the guardian of the board's effectiveness and its behaviours/ethics/values system
- lack of insight and questioning of the board's functioning and effectiveness – many shareholders, institutional investors and stakeholders have been very complacent in



over depending on 'high-profile experienced board chairs and non-executive directors' and not asking the obvious questions to understand if the board is actually working well. Questions such as the level of board diversity, regular refreshing of the board, searching external board evaluations taking place and comprehensive Section 172 statements with genuine depth

- an unbridled unbalanced commitment by the board to maximise shareholder returns by all means necessary and often in short-term market driven horizons, at the expense of customers, employees and broader stakeholders – in many cases, this blind focus on shareholder returns actually ended up with major destruction in shareholder value.

In parallel with any future strengthening of corporate governance codes, external audit and regulatory oversight, a strong focus on the following key areas, will significantly reduce the potential for a board failure and avoid the often catastrophic damage board failures can cause to shareholders, employees, customers and broader stakeholders.

Board Composition and Diversity

One of the most common underlying causes of board failures is a board diversity problem. This creates an environment where groupthink can flourish and the natural instincts of a highly diverse board with a deep commitment 'to do the right thing' is not present to counterbalance the worst human attributes of arrogance, greed and hubris. The diagram above illustrates the compelling case for diversity in every single board of directors, whether it's a PLC board, a private company, charity, non-profit public sector or membership/ trade body. While progress has been made in terms of female diversity on company boards in the UK and Ireland, we still have a journey ahead and there remains a serious problem of 'preservationist board chairs' who stubbornly refuse to improve the diversity of their board in terms of gender, age and sector background, as well as a growing focus on ethnic/geographic background and customer demographics.

In evaluating boards week to week I am always encouraged to see genuine board diversity representing a wide range of thinking styles, perspectives and an ability to consistently ensure that proper balanced consideration is given to shareholders, customers, employees in terms of major decision-making and risk assessment.

Independence of Mind

One of the absolute core tenets of corporate governance is the role of non-executive directors in bringing strong levels of 'independence of mind' to the board table that underpins robust challenge of the CEO/executive team, their fellow board members and of the prevailing status quo. The level of 'independence of mind' is inextricably linked to board diversity. In analysing the post-mortems of many boardroom failures, there were moments where there were enough clues and warning signs that all was not right and that strong independent challenge and demanding of answers were needed by the non-executive directors. Instead, many non-executive directors, many of whom with decades of experience, did not stand up to highlight serious concerns – in some cases because they were going through the motions and not working hard to probe more deeply and in other cases – because they did not want to ruffle the feathers of a dominant CEO. This latter case is actually far more damning as it means that key opportunities were missed to potentially avert the crisis because a non-executive director who knew that something was potentially seriously wrong, decided to take the easy way out and look the other way. Regular refreshing of the board composition has a key role

not only in improving board diversity but also maintaining strong levels of 'independence of mind'.

Courage in the Boardroom

Courage might seem like a strange phrase to use in the context of the boardroom but in my experience, it is a fundamental quality that every board director must have to always be prepared to stand up and do the right thing to protect their customers, employees, shareholders and broader stakeholders. In researching closely the handling by the Boeing board of directors of the 737-Max scandal, I genuinely wondered how many of the non-executive directors stood up at the board meeting following the first crash to say something along the lines of: "There is potentially enough evidence at this stage that further crashes could take place with appalling loss of life. We have an absolute duty of care to the passengers that travel on our planes, their family and loved ones, our airline customers, regulator and broader society – this has to transcend the inevitable commercial damage grounding our fleet now will do to us as a company and our shareholders but this is absolutely the right thing to do, how can we as a group of experienced board directors gamble with people's lives?" In the case of financial services company boards, the board directors knew that misselling of products to consumers was rife and mortgage customers were treated appallingly, yet who stood up for those customers? This goes to the very heart of what represents 'the board's conscience and moral compass'. In many cases of board failures, board directors simply did not have the courage and decency to stand up to say, "this is fundamentally wrong", and to ask the hard questions.

Searching Honest Board Evaluations

Traditional approaches to external board evaluations were very compliance-centric and in some cases have, unfortunately, become tick-box exercises. Modern progressive board evaluations have evolved beyond this and have a far greater focus on board dynamics, behaviours, culture, ethics, understanding the 'people equation of the board' and to ask the searching question of "is this board excelling for its shareholders, employees and stakeholders?" In the age we are living in, in terms of a strengthening focus on Environment Social and Governance (ESG), there is a special responsibility entrusted to an external board evaluator to undertake a board evaluation that has at its heart, the best interests of the shareholders and stakeholders. As an external board evaluator, I have delivered my fair share of bad news to boards of directors across a wide range of sectors. If there are 'elephants in the boardroom' that are seriously impacting the functioning of the board and executive team, I have a fundamental duty of care as an external independent board evaluator to call these out to help the board face up to these and address the issues identified. If that happens to be an overly dominant CEO, an under-performing board chair, poor culture/ethics, serious diversity problems, poor levels of challenge and debate, then so be it. This can be difficult for some board chairs, CEOs and board directors to accept, but in my view there simply is no other way. In the majority of cases board chairs and boards have appreciated my honesty and commitment to help them face up to and address the challenges. Board chairs in particular have a key leadership role in encouraging deep honest board evaluations that are searching and ultimately if embraced properly, will help the board drive sustained improvement in their board effectiveness, governance and performance.

Stakeholder Capitalism

One of the key drivers behind the growth of ESG and the transition to stakeholder capitalism is a realisation that the inherent mechanisms of how it translates to the boardroom, result in a far greater balance within the board, a far greater focus on genuine board diversity, range of thinking styles, culture, ethics/values and a strengthening of the focus to do the right thing for long-term sustainable success for all shareholders and stakeholders. I believe that the growth of ESG and the ongoing shift to 'stakeholder capitalism' will translate over time to a reduction in corporate board failures. Some of the most appalling boardroom failures and scandals have occurred where the board of directors have sacrificed customers and employees 'on the altar of corporate greed' either quite deliberately or through poor behaviours at individual and collective board level.

Summary

While future sensible strengthening of corporate governance codes, the external audit regime and increased regulatory oversight will always be helpful, the sad reality is that the vast majority of board failures come down to people, their behaviours and in many cases an abject failure by the board chair and individual board directors to protect their shareholders, employees, customers and stakeholders. A large majority of these failures have been on the watch of board chairs, non-executive directors and CEO/executives with decades of experience who knew exactly what their responsibilities were, understood what good looks like in corporate governance and yet, wilfully and through neglect, failed in their duty of care and responsibilities. The growing focus on ESG is shedding a new light on board composition and diversity, the board's culture, ethics and values, courage in the boardroom, 'independence of mind' for non-executive directors and the solemn responsibility of each director 'to do the right thing' for all shareholders, customers, employees and stakeholders.

These collectively all contribute to a board's conscience which could be the most important factor of all to significantly reduce boardroom scandals over the coming years.■