Courage in the boardroom and ESG's key role in enabling this

Description

Courage might seem a strange word to talk about in terms of the boardroom and boards but as we get ready to enter a new decade, **courage is a quality that is vital within a boardroom to ensure that at pivotal moments the board does not lose sight of its overall responsibilities to stakeholders and shareholders and the absolute need of a board of directors "to do the right thing".**Around the world, we are witnessing the momentum and impact of Environmental, Social and Governance (ESG) as institutional investors, shareholders and stakeholders engage with boards of directors in new ways and are starting to fundamentally change their expectations of boards in terms of prioritising long-term sustainable success and to raise the bar significantly on the standards boards and executives will be held to in terms of culture, ethics, behaviours and values. While a lot of the early focus of ESG has been on Environmental and Social, *I believe there is something very fundamental emerging around the "G" in ESG with shareholders and stakeholders and the public at large significantly increasing their expectations in terms of governance and boards "doing the right thing" even if it is at the expense of short-term financial performance.*

Boards of directors are no different to any other area in life in terms of exhibiting the full range of the "human condition" in terms of culture, ethics, values, behaviours and the dark sides of greed, power, bullying, harassment and selfishness. A boardroom can be a very intimidating environment with the potential for a lot of very strong-willed domineering personalities with self-serving agendas that in some cases are light years from the high standards that should be expected of a board of directors.

Over the years in working with boards teams, I have seen an incredible range of scenarios where board members bravely stood up to call out either major issues that would seriously damage either customers, shareholders and stakeholders or to force the board to face up to very serious problems impacting the board or employees such as a CEO or Board chair demonstrating bullying behaviours towards executives and board members or sexually harassing employees. I have also seen cases and I am sure each of you have seen in either your own board experience or in high-profile cases in the public domain, where board members did not demonstrate the courage to stand up and allowed the board or a sub-set of board members to continue to act in an in-appropriate manner and in some cases, make decisions that fundamentally damaged customers, shareholders and employees. Group-think is a very serious problem and as we saw in the financial crisis, can very easily grab hold of even the most experienced board team unless there are a sufficient number of genuinely independent non-executive directors who stand up and are counted in terms of providing very robust oversight and challenge to the CEO and executive team.

I had this article in mind for some time but what finally prompted me to write this is the unfolding events at Boeing and the scrutiny of the board's handling of the 737 Max crisis not only now and in recent months but going back several years when the new plane was undergoing testing and certification. In the US on the 29thOctober, the CEO of Boeing Dennis Muilenburg was quizzed by the Senate Commerce Committee. A number of Senators said they had serious concerns that Boeing put profits over safety as it pushed to get clearance for the 737 Max. Two deadly 737 Max 8 crashes killed a total of 346 people. Mr Muilenburg admitted the firm had made "mistakes". "We have learned from both accidents and identified changes that need to be made," he said. Lawmakers accused Boeing of being aware of problems in the automated control system in the 737 Max 8, known as MCAS, which was acknowledged by the Boeing CEO at the Commerce Committee hearing as factor in both crashes. Forbes commented on September 25th that *"Boeing's board has formed a new safety committee and drawn up a blueprint to strengthen the independence of its engineers and safety certification representatives from commercial pressures, in response to two deadly crashes of its flagship 737 MAX airplane.".*

Potential questions that could be asked of Boeing's board of directors consist of

- Did Boeing's push to get the 737 Max plane certified to release the huge revenue uplift that came with this in the hyper-competitive fight against Airbus, blind the board to the company's absolute responsibility to ensure that the plane was safe and that any serious issues that were identified were properly addressed (such as the concern flagged about MCAS back in 2016 by a chief test pilot which the Boeing CEO confirmed at the Senate Congressional hearing that he was aware of)?
- Did the CEO and senior executives make the board fully aware of the concerns around MCAS, was there a serious group-think problem at the Boeing board or did any of the independent non-executive directors stand up and ask the very hard questions about the accelerated certification programme with the FAA and how did the board collectively satisfy itself that any outstanding safety issues were resolved and the new plane was genuinely safe to fly?
- After the first 737 Max crash in Indonesia, did the Boeing board of directors seriously consider making the decision of themselves to ground their entire fleet knowing that there was the potential that the crash could have been possibly related to the MCAS feature? How would Boeing's shareholders have reacted to such a decision for Boeing to initiate the grounding of the 737 Max fleet? It would have been very interesting for shareholders, employees and stakeholders to have seen a live stream of this particular board meeting and the emergency board meeting that took place after the 2ndcrash in Ethiopia to witness the level of challenge, debate, oversight, behaviours and mind-sets of the Boeing board non-executive directors and executive team in terms of their approach to balancing "the health and safety of their customers' lives" and Boeing's quarterly and medium-term/longer-term financial performance.

The questions being asked by the Senate Commerce Committee of the Boeing board culture and its decision-making are not unique and have been played out in many board and corporate scandals in recent years. It is interesting to see how major institutional investors have reacted to the events ongoing in Boeing. Bank of America Merrill Lynch (BAML) pointed out that Boeing has only one engineer and one person with a science degree on its board, leaving a gap for oversight into environmental, social, and governance concerns. "We see increased uncertainty related to the Max return to service timeline, Boeing's culture, brand and corporate governance," BAML analysts said in a note to clients on October 21st2019. The firm continued: *"Risk management, disclosure, and accountability of management and the board are key ESG investor concerns and could weigh on the stock in the wake of this setback."*

I strongly believe that ESG could provide a unique opportunity to fundamentally change the mind-sets of boards of directors and that "doing the right thing" for all shareholders and stakeholders is the absolute priority rather than a slavish over-bias to shareholders' financial short-term interests in those cases where it is fundamentally in-appropriate in terms of the

devastating damage to people and the environment that a particular course of action could result in. When the Business Roundtable of 181 leading CEOs announced in August that the “era of true multi-stakeholder engagement and long-term sustainable stewardship” had arrived, it was seen as a seminal step that built upon by the decisions of some of the world’s largest institutional investment funds such as Blackrock to usher in a new era of sustainable investment which would be underpinned by a significant increase in the standards of corporate and board responsibility.

*We are at the stage now where national corporate governance codes can’t significantly strengthen much further.*We support board clients in the UK and Ireland bring the UK Corporate Governance Code (2018) to life as the central core of their governance and stewardship. This latest version of the UK Corporate governance code is extremely progressive, embraces ESG, the critical role of employees and multi-stakeholder engagement and I sincerely believe represents one of the strongest if not strongest national governance codes globally. But as we have seen in recent corporate collapses such as Carillion, governance codes are not enough and it is in the “people equation of the board” where the culture, ethics, behaviours, values and ultimately decision-making play out to shape a board and company’s actions.

I fundamentally believe that in many respects the longer term potential to usher in a new level of corporate governance and board stewardship is in the hands of institutional investor and shareholders. All of the governance tools are there in terms of national and sector specific governance codes, regulation etc. – the missing piece of the jigsaw is a sea-change in the attitude of institutional investors in terms of mandating that their boards

- Demonstrate the highest standards of culture, behaviours, values and ethics in which every single board member and executive must “walk the talk” in terms of their behaviours
- Provide far stronger insights into the board’s effectiveness, performance and culture and that a genuinely diverse board exists, with every single board member genuinely pulling their weight and adding significant value with exceptional levels of robust oversight, challenge and debate, where the board is refreshed regularly to ensure an optimum mix of generalists and sector specialists up to speed with the latest technologies and business model disruption etc.
- Take decisive action to address serious shortcomings in the behaviour of any board member irrespective of their position, profile and tenure with the board
- Demonstrate genuine diversity and “independence of mind” in terms of the board composition across
    - Gender
    - Age
    - Customer demographic
    - Thinking style
    - Ethnic background
    - Sector background
- Encourage the independent non-executive directors to absolutely embrace “independence of mind” and

that when it is needed that all board members and executive directors demonstrate the courage to speak out and call out "the elephants in the room" when it comes to very serious issues that could have a catastrophic impact on customers, employees and shareholders.

- Demonstrate a genuine commitment to regularly refreshing boards and avoiding long-term group think problems and independent non-executive directors losing their independence and critical spark of challenge and robust oversight

For far too long, institutional investors have made far too many assumptions about what's really going on within the boardroom of their portfolio companies in terms of the actual culture of the board, the level of high quality robust challenge and oversight, the level of outstanding board chair leadership, the level of genuine diversity and the approach to major decisions and how the overall interests of all stakeholders, employees and shareholders are taken into account. In many cases, I have seen institutional investors make a very significant assumption that by having high-profile "seasoned" non-executive directors on the board that this would automatically translate to a highly effective board with an outstanding culture. **Excellence is not the default position of any board of directors – irrespective of the profile and CVs of the board members around the table.** My sense is that the pension funds and the public at large who are investing in the large institutional funds are asking more and more questions about how the institutional investors are placing ESG at the heart of their investment strategy and how they are significantly increasing their expectations of their portfolio companies.

It is very heart-warming to see the strong growth in impact investment and the major increase in focus on environmental and social issues across the world as part of ESG. *In five and 10 years time, we may look back and see that the greatest legacy of ESG could in fact be a new era of "enlightened governance" where boards of directors, both individually and as a team, **embrace that their absolute priority is "to do the right thing"** in a multi-stakeholder model providing the highest levels of genuine stewardship that enables long-term sustainable success for all stakeholders, employees, customers and shareholders.* Martin Luther King at the commencement address for Oberlin College in Ohio, 1965 said **"The time is always right to do what is right"** – as we enter a new decade it has never been more important for board directors, whether on the board of a large listed company, a non-profit or charity board, **to have the courage to do the right thing when it is critically needed.**

*Kieran Moynihan is the managing partner of **Board Excellence (https://boardexcellence.co.uk** and **https://boardexcellence.ie)** – supporting boards & directors in Ireland, UK and internationally excel in effectiveness, performance and corporate governance.*

Date Created
06/12/2019