The ugly, the bad and the good

Reflections on how executive teams share bad news with the board.

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I was once in a situation where, about 40 minutes into a board meeting I was observing, a sharp **NED** asked a probing question about a sales performance problem. As the Sales Director started to explain the issue, he inadvertently mentioned that it was the result of the loss of a key customer. This fact was not mentioned in the board pack, so the NED started to probe more deeply, asking whether any other key customers had been lost recently. At this stage, the Sales Director was visibly uncomfortable, but answered truthfully that this was one of several key customers lost recently due to product quality problems. At this pronouncement, I saw the colour drain from the **CEO's** face. All of the NEDs got quite animated and a literal Pandora's box was opened as this serious material issue took over the whole board meeting.

At the end of the meeting, the chair and every NED expressed, in no uncertain terms, how upset they were that the executive team had deliberately sat on quite a serious issue, remarking how this had damaged their trust that had been nurtured over many years. Thankfully the CEO took responsibility, admitting to the adoption of a 'hope is a strategy mode' to try and fix the problem, which had actually only got worse.

This anecdote serves to highlight how the current difficult market and economic conditions are putting a lot of executive teams and their boards under serious stress and testing bonds of trust.

Over the years, I have seen huge variation in how executive teams handle the sharing of materially negative developments and problems with the board. This goes right to the heart of board dynamics, board effectiveness and the trust that underpins high-performing boards and executive teams. It can also be a key factor in company or organisational scandals, as there is often a missed window of opportunity when, if the executive team had been brutally honest with the board earlier, collectively they would have had a far greater opportunity to address the issues and take concrete action to avoid a problem spiralling out of control.

Barriers to honesty

There are a number of factors which impact on executive teams being totally honest with the board about negative developments and problems.

1. The most common reason executive teams struggle to share bad news with the board is that they are frantically trying to fix the issues. These efforts will be made in the hope of either avoiding having to tell the board, or being able to let the board know that, while there may have been a problem, it has been either resolved or significantly reduced in impact. This is a very recognisable feeling, and boards fully understand that executive teams should have some time to handle problems before needing to highlight them. The problems begin when executive teams lose objectivity, get into a 'hope is a strategy mode', and things get worse not better. Ironically, this makes it harder to face up to the need to inform the board.
2. Standing in front of the board and sharing serious performance problems makes executives very nervous. These types of

challenges may have implications for their own standing in the board's estimation. Depending on the scale of the problem and the extent to which problems are self-inflicted, a CEO or executive may be very fearful that this type of revelation could trigger the board to start reflecting on whether it is time to replace a senior executive.

3. A culture of over-reaction to bad news and the board 'hauling an executive over the coals', rather than focusing on constructive support, can make executives more reluctant to be honest with the board. A CEO once described his board meetings as 'entering the lion's den', where being totally honest about performance problems was akin to putting a large target on his back.
4. In some cases, an executive team can either be blind to, or too close to the problem to realise its scale and seriousness, and its potential to spiral out of control.
5. Many executive teams develop an ingrained habit of focusing too much on the good news. By default, these kinds of executive teams will tend to avoid being completely open with their boards by downplaying problems or hiding them in a complex board pack. This is disrespectful to the board and is quite commonly seen as the root cause of company or organisational scandals and collapses across the world.

The consequences

The failure to share materially negative developments with the board can have significant consequences for organisations.

1. An immediate consequence is serious damage to the trust between the NEDs and the executive team. Naturally, NEDs in this situation will begin to ask what else the executive team may be hiding from them. All of a sudden, the integrity of board packs and management information is called into question. It can be very difficult to recover from such serious fractures of the trust between NEDs and the executive team.
2. When NEDs start to question the openness and honesty of an executive team, it can often destroy board dynamics and completely undermine the virtuous cycle of challenge, debate, respect and trust. When NEDs start to second-guess the executives, won't take anything at face value and – in some extreme cases – end up interrogating executives, you inevitably end up in a 'them versus us' mentality. This is a nightmare scenario for the board and executive team, not to mention the shareholders and stakeholders who are depending on them working well together.
3. Quite a serious consequence of holding back on sharing materially negative developments and problems, which is often overlooked by executive teams, is that it robs the organisation of the opportunity for the board and the NEDs to help. All of the potential value the NEDs could bring in terms of their expertise, experience of dealing with similar challenges, independence of mind and ability to 'see the wood from the trees', is completely lost.
4. The most serious consequence of all is where a problem has

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degraded to the stage where it is too late for a board, however experienced, to intervene positively. There are countless examples of even quite experienced executive teams losing their way badly and holding back from the board on the scale of the problems. In many instances, the result of this is that the whole organisation comes crashing down, bringing the inevitable soul-searching among shareholders, employees and stakeholders who ask why the NEDs were asleep at the wheel.

Guidance for executive teams

My advice to executive teams who know they have some bad news to share is not to shy away from the ugly, the bad and the good – in that order.

Share serious materially negative developments and problems early and in proper context.
A simple litmus test of when it is appropriate to share bad news is to answer the question: if I was a NED serving on this board, would I want to know this now? There may be times when the full ramifications are not completely clear; in those cases, it is appropriate for the CEO to provide guidance to reflect this, but it is not a reason not to be up front about the issues.

Put your hands up and own the problem.
The vast majority of NEDs were once executives themselves; they know that things go wrong, poor judgement calls are made and sometimes things can happen outside of the executive team's control. What the NEDs want to see is ownership of the problem, strong commitment to addressing the issues, openness to their guidance and support, and all energies being put into solving or mitigating the problem rather than defensive behaviours.

Enable the NEDs and board to help.
Many executive teams don't realise that some of the best value NEDs can bring is realised in times of crisis. There is a pretty good chance that high-calibre NEDs will have dealt with similar problems before. Many executive teams have told me of countless instances when NEDs provided valuable support and were able to highlight that the executive teams were too close to the issues. In these examples, sharp guidance from NEDs can be invaluable in developing an action plan.

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Maintain trust with the NEDs and the board.
Trust is the single most important factor in how an executive team and board work together. However challenging it may be to share the consequences of poor performance or a bad judgement call with the board, it is still preferable to dealing with the aftermath of a serious breakdown of trust. In the vast majority of cases, it is only a matter of time before the news breaks anyway, and when trust is broken, it can be very difficult to rebuild. Sometimes it is irreparable and CEOs and executives are replaced as a consequence.

The executive performance implications should be dealt with separately.
When things have gone wrong, it is vital that the NEDs and executives prioritise addressing the problems. There will be a separate, appropriate time to deal with any potential knock-on performance-management considerations and consequences for executives.

The scale of fiduciary and legal responsibilities resting on NEDs' shoulders has never been greater. Their ability to demonstrate high-quality robust oversight, challenge, debate and decision-making in protecting the overall health of the company is dependent on the quality, honesty and timing of the information provided to them by the executive team.

The openness and honesty of an executive team underpins the trust and respect between them and the board. It is this trust which enables them to engage as partners. This is the hallmark of a modern executive team–NED board partnership model and creates the best environment for the two to work together to understand, mitigate and overcome serious challenges.