Board Risk
Article by John Plender
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Is a Board at Risk by Being Comfortable with Themselves?

This article is intended to stimulate a constructive discussion around the boardroom table on the value that independent board members might bring. The approach of this article is not academic, but rather it aims to provoke the reader to think, question and act towards adding (more) independent directors to the boards in the Gulf region.

This is relevant as many companies in the Gulf often have boards that comprise of non-executives who already know each other, which is fully understandable from an historic perspective. The vast majority of companies in this part of the world originated as small family companies where the founder was very much instrumental in building the business. As many of them developed into mid-size and larger companies, the founder became chairman and a trusted family member became the CEO. And that has worked very well in many cases.

Several of these companies have developed and expanded successfully into the second and third generations. Some have become entrepreneurial beacons in their respective markets and several even beyond their home-markets.
As the size and scope of these businesses expanded, their level of complexity multiplied. This required investment in support systems, enabling the generation of sufficient financial information to run their businesses effectively.

Also, the realization emerged that management of these companies needed to be upgraded, with better skilled people. Similarly, the leadership needed to elevate their competencies, specifically where it related to strategy, profitable results orientation and building organizational capability. In the meantime, some companies set up boards to provide oversight on behalf of the shareholders, who themselves gradually became more remote from their business. Often these boards consisted of trusted insiders such as family members, supplemented with well-known business leaders from the same area. At that stage of development of these companies, their boards predominantly had an operational mind-set.

Often, this operationally driven mind-set led to a feeling of “control” over the business, which provides a certain level of comfort to the shareholders. However, this control negatively affects the chances to attract a highly competent CEO from outside. This is unfortunate, particularly for companies which face growing complexities and increasing market volatility as they would require highly competent C-level leadership.

In other words, the opportunity cost of an operationally-controlling insider board could become very high. The board deprives itself of keeping the oversight that is required to ensure that the CEO is running the business well. This is the story of seeing the wood from the trees. This could even seriously affect the effectiveness of its executive leadership: unfortunately, it often happens that a highly competent CEO, when heavily controlled by his board, might depart, leaving the company leaderless for a while, which is a serious risk to shareholder value and sustainability of the company. As we know, it takes precious time until a successor has been integrated, fully up and running.

Moreover, if the group-think in the Board translates into being and acting an operationally-controlling board, it then effectively deprives the board of the opportunity to discuss a relevant company strategy. In short, it denies itself of its key purpose and its potential to deliver true added value, which in turn is a serious risk to the long-term sustainability of the company.

In the end, the same holds true for a board that has become too comfortable with itself. The discussions in these boards tend to be routine and follow certain rituals with regard to who speaks up and to what extent. The agenda is standard and, when probing deeper, it avoids the difficult discussions. Often, this happens when board members know each other well and find it difficult to challenge each other around the boardroom table. In our GCC Region, a culturally engrained respect for each other and especially for the elderly plays an important part in this matter. This is understandable, but also risky in times of complexity and volatility.

**VALUABLE INSIGHTS**

Over the many years in my leadership advisory positions, I have observed a large number of boards and business leaders, and I have had keen interest specifically in observing their decision-making processes. I was able to do this from the position of being an objective ‘outsider’ to their companies. It frequently struck me that, when companies slowed down in their performance, this was often coinciding with a limited decision-making capability at board level. Either through lack of relevant up-to-date knowledge on strategic market developments, or by an inability to maintain open, constructive, challenging discussions around the boardroom table; incapable to deliver well on strategy and oversight. Many boards seemed to have been rather blocked by a rosy perception that they “have all been CEOs and know how to manage a business”, or by convictions such as “we...
trust our CEO,’ ‘our Chairman and CEO go well together,’ ‘we all know each other well’ etc. These are typical indicators for a high level of group-think. Rather unfortunate and very costly, specifically in those situations where companies moved through periods of high risks, which repeatedly resulted in sincere crises. The costly stories of the dot-com bust, the financial crisis, the real-estate crisis and their aftermaths are all well-known.

However, “never let a good crisis go to waste”. There is high value to be obtained via actively learning from these mistakes, and benefitting from their insights. An important, and recurring, observation in many mishaps, and repeatedly described by a range of authors and consulting firms, is that these boards did not function at their best. The quality of the discussions around the boardroom table had been quite limited, and with it, the capability to take right decisions when they were needed most. Repeatedly, a certain level of group think prevented to entertain truly challenging discussions; causing huge losses in shareholder value and negative impact on the sustainability of their company. Often, these boards had a lack of truly independent directors, a lack of a relevant mix of skills and lack of diversity in backgrounds.

Specifically considering our GCC region now, as mentioned above, we usually see boards being comprised of non-executives who already know each other. While this is helpful on the important angle of trust, it might effectively limit the quality and depth of the discussion around the boardroom table. This might lead to group think, a limited decision-making capability and a tendency to discuss what is already known; and hence, often a tendency to dwell in operational control. These days, I hear more and more investors, executives and also Board members indicating that this operational control is not the most effective way to operate as a Board. Effectively, the current modus operandi by many of these Boards might be a source of serious risk to the sustainability of their company, with a negative impact on shareholder value as well. Nevertheless, it seems a modus operandi that is still very much prevalent, and somehow well-accepted, in the GCC region. Although there is growing recognition that boards would benefit from alternative points of view, a
well-considered mix of skill sets in the boardroom and more diversity, yet this recognition has not been translated into practice in this part of the world. For many boards, and for their shareholders who vote for them, it seems quite difficult to embrace the idea of adding well-qualified independent board members, who would be able to voice the alternative points of view, and to bring relevant skills and diversity as well. Have these boards become too comfortable with themselves? Are they still able to deliver the best corporate governance that they ought to deliver?

GETTING INTO ACTION

How could a shift in this modus operandi be stimulated? How could boards and shareholders be encouraged to be more open to the idea of nominating “outsider” independent board members instead of nominating another non-executive whom they already know, or nominating another representative from a major shareholder. In my experience, asking open questions triggers constructive dialogues. The same is true when tackling this important but sometimes sensitive topic. The prevalent practice of sharing and lecturing best practices from other markets is insightful, but a more active interaction, triggered by skillful questioning, does actively stimulate an internalized desire for attracting independent outsider board members.

The approach that I would advocate, is to start with asking specific and deliberate questions, aimed at helping to increase awareness on the topic. Sometimes, these questions might feel somewhat provocative, but that is when the discussion opens up. No awareness, no action; it is that simple.

Once awareness is there, real critical thinking on the answers and their consequences starts to occur. Then, one does start to objectively question the status and effectiveness of the modus operandi of their current board; this could even lead to a multi-dimensional discussion on the need for an objective board effectiveness review. But often it exposes the true need for the added value that knowledgeable outside independent board directors would bring to the boardroom table. This holds true for family companies, stock-listed companies, but also government related companies alike. Essentially, they all will benefit from enhancing the quality of the boardroom discussion; and thereby, the quality of boardroom decision making.

To provide the reader of this article with something to work with already, I will share some effective questions here. The first series starts very basic, such as:

• What is the role of the board?
• Which capabilities do you need to be able to fulfill your role as a board?
• To what extent do you have these capabilities around the boardroom table?
• How relevant are these capabilities now?
• How relevant will these capabilities be in the future?
• Are you satisfied how you function as a board? Why? Based on what?

More probing questions that dig a level deeper are:

• What are your objectives for the board?
• How would you characterize the discussions around the boardroom table?
• Are you able to openly discuss a difficult topic? From various angles?
• To what extent do you openly ask questions about what you do not yet know?
• How much in-depth do you really discuss the risks that your company might encounter?

Even more provocative would be to ask:

• How comfortable are you with each other in the board?
• How does ‘being comfortable’ impact the quality of your corporate governance?
• How big of a risk is that to the company?
• Can you afford this risk? Why?
• What should an independent board member add to the capability of your board?
• Where would this have most impact on your performance as a board?

When it comes to the point that adding outside, knowledgeable, independent board members is being considered, then the nomination committee should work on the required profile. In the write-up of the profile, the nomination committee should be very specific on what the role of the to-be-attracted independent board member should be. From that perspective, they should formulate the required background, experience, knowledge, skills, competencies and personality that they will seek in candidates for this important role. This profile write-up is highly significant: it not only functions as an outline to compare relevant candidates with, but also functions as an internal contract on what has been agreed to when adding new member to the board. Often, the nomination committee would benefit from the professional support of a subject matter expert, who would guide them through this important process.

Once the right candidate for the board position has been selected, a dedicated induction program for this new director should ensure he/she quickly becomes knowledgeable on the history, status and outlook for the company. This would include meeting the leadership, as far as relevant for proper functioning as a board director.

GOING FORWARD

The aim of this article is to contribute to stimulating a discussion on the considerations for adding independent board members to boards for a range of companies in the GCC region - not only for family-owned companies, but also for stock-listed and government-related companies. In current times of rapidly growing complexity for the company and increasing volatility in the markets, they all would benefit from avoiding group-think and enhancing the quality of the discussions around the boardroom table. They all would benefit from considering bringing more independent 'outside' board members into their boards: 'outsiders' who would be able to ask questions about the unknown, about the factors that might drive risk and sustainability for these companies. Further strengthening these boards with more diversity in their membership, and with a well-considered mix of skills would elevate the quality of their decision-making processes even further. When handled with the right level of professional care and guidance, these processes would contribute to reduce risk, and enhance shareholder value and long-term sustainability of the company.