DYSFUNCTIONAL BOARDS: IMPACTS ON ORGANISATIONS AND REMEDIES

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Business Seminar: Presentation by Terrance M. Booysen (CEO: CGF Research Institute (Pty) Ltd)

Power of the board

As we all know, boards are powerful forces; and through their collective knowledge, skills, experiences and practice, their output is intended to cause positive and sustainable change for companies. Today -- more than ever -- having a high-performing board is a critical success factor for company leadership and the company's performance. It is therefore imperative that boards function well in order to have a positive impact on the company, and ultimately a country.

Michael Judin (Right), an Honorary Patron of CGF and Senior Partner of Judin Combrick Inc. leads the panel discussion (Left-Right); Volker von Widdern (MD: Marsh Risk Consulting), Peter Flynn (MD: Standards & Legal), Lucian Carciumaru (Director Operations: Camargue) Terry Booysen (CEO: CGF) & Angela Dick (CEO: Transman)

But when boards get it wrong -- and there are many examples to mention -- the devastation can wreak havoc throughout a company and the effects can be felt for many years afterwards.

We only need to cast our minds back to the 2007/08 global financial crisis which was caused through failures in the international banking sector's corporate leadership, where they created too much money, too quickly and they used it to superficially inflate house prices and the 'bubble' so to speak, eventually burst. The global financial crisis is probably an ultimate example of dysfunction, and lessor examples of alleged board dysfunction such as the recent cases of the SABC, SA Post Office, SAA, Pinnacle Holdings, VW and MTN pale in comparison. It is believed that a good board will not make a company, but a bad one will inevitably kill it. It has also believed that troubled boards outnumber functional boards by a wide margin.

Recognising board dysfunction

It is imperative that we are able to detect -- at its early stages -- when the board is leaning toward some form of dysfunctionality, and it is critical that these are addressed well before any serious problems occur. A dysfunctional board typically fails to make decisions that are in the best interest of the company and this causes several problems for the company. Understandably, the impact of a dysfunctional board is bad for the bottom line. Dysfunctional boards can tarnish or destroy entire brands, as well as leave an ugly stain on the reputation of the company's directors.

The most common warning signs of board dysfunction may include:

- overly dominating (or arrogant) individual/s;
- inability to work through difficult conversations / shutting off debate;
- lack of communication;
- inability to focus on goals;
- inability to make decisions / avoidance of accountability;

- personality clashes and / or conflict;
- overstepping board of director roles;
- lack of teamwork / commitment;
- inattention to results;
- fear of the unknown;
- non-participation;
- personal or political agendas, and
- absence of trust.

Source: 'The Five Dysfunctions of a Team', by Patrick Lencioni

In his book, "The Five Dysfunctions of a Team", Patrick Lencioni sets out five main areas which he believes will lead to a team -- or board for that matter -- becoming dysfunctional. Interestingly, through the use of a pyramid schematic, at the base of the pyramid we find TRUST -- or its absence -- this being the root cause of most dysfunction.

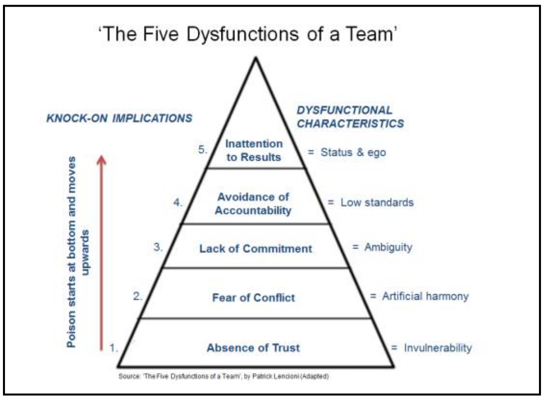
Think of the mistrust element as being the toxin which poisons the next four elements in this pyramid. Leading from a lack of trust which may be found amongst the board members, one can then expect the issue of CONFLICT to arise. When we speak of conflict, we are specifically referring to *unproductive* conflict which is a completely negative element. Of course, as mistrust and unproductive CONFLICT are allowed to brew within an already tense boardroom, issues of individual and / or collective non COMMITMENT is most likely to arise.

With these three toxic ingredients at play, it is inevitable that the members of a board will try and avoid any areas where they are held personally ACCOUNTABLE and this predictively will lead to negative RESULTS of various forms in the boardroom, and ultimately the company at large. It is important to note that TRUST between the members of the board cannot be overlooked. This is after all one of the key ingredients which either makes relationships work or fail. When any form of mistrust is allowed to breed amongst board members, it creates a 'superficial harmony' amongst board members. In these circumstances, there is a lack of genuine discussion and robust debate between the board and its members. In the absence of robust debate -- being one of the key duties expected of directors -- how can it be said that they are serving the best interests of the company? Expectedly, when trust fails in the boardroom, everyone feels the tension and relationships are tested to the hilt. This is also one of the main reasons why boards become polarized and lobby groups are formed, most often manifested by a stand-off between executives versus non-executive directors.

This situation, being just another example of boardroom dysfunction, has a direct (negative) bearing upon boardroom decisions, particularly when these decisions are contentious and the full commitment of the board is required. Indeed, through mistrust, the full commitment of the board will be lacking. This lack of commitment is quite bizarre, considering the fact that a board member may have agreed to certain of the actions at a board meeting, but inwardly he or she does not support some and / or all of the board decisions. Behaviour of this sort could also be the result of board members who are:

- low on IQ / EQ and self-esteem;
- fixated by their own egos;
- not truly concerned with the affairs of the company (but more so their own);
- fearful of addressing conflict;
- not committed to the objectives of the company (neither the board), and
- not committed to building and maintaining solid business relationships.

Indeed, when speaking of individuals who occupy board positions, it is not uncommon that when they first began their directorship career, they may have been somewhat 'naïve' in many of their duties, and they would have diligently followed good practices of directorship. However, the sad reality of success and power for many individuals (i.e. accepting our human frailty) is that success can go to one's head and in these circumstances, their priorities are no longer focused upon the company, but rather their own. As these individuals change, so their rules apply and no longer those of the collective?



Some of the common pitfalls these directors may fall into include:

- becoming tunnel visioned (e.g. unapproachable, lost perspectives, rigid);
- losing their fear (e.g. invincibility, irrationality);
- fear of failure (e.g. too risk averse);
- arrogance (e.g. know it all);
- isolated (e.g. elitist / insular mentality, ivory towers, excessive structures & bureaucracy);
- controlling (e.g. micro-managing); and
- surrounded by "yes-men" (e.g. only want to hear good news to pump their egos).

Dealing with board dysfunction

In a fast-changing world, leaving a board in a dysfunctional state is a sure recipe for company disaster, both internally and externally. An explicit process -- including proper policy -- must be put in place to deal with a dysfunctional board of directors. The process should be implemented before real problems occur and which would become more difficult to resolve if it were left unchecked. The fiduciary duty owed by the board to the company -- collectively and individually -- must urgently seek to eradicate any dysfunction within the board (or its members) and create a more productive climate to achieve the company's objectives.

As mentioned earlier, TRUST is a key issue and it is imperative that the members all trust each other and this can only be achieved over time, as well as through team work ('bosberaads' may also assist, but only to a small degree). What is however important is that directors should not be fearful of addressing dissenting views and or opinions, including conflict amongst themselves. Indeed, it would be safe to say that directors are not expected to always agree on matters, and it is incumbent on directors to state their varying opinions (or disapproval) -- with sound reasoning -- should they believe this would be in the best interests of the company.

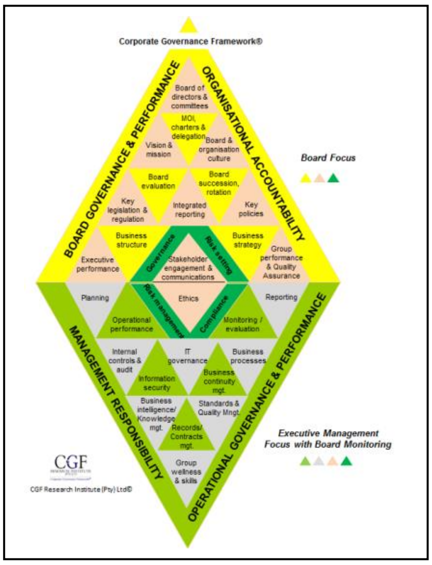
Therefore it is incorrect for any director to believe a position on the board will always be a "bed of sunshine and roses". When directors are able to approach matters where they differ from their peers, and when this is done with respect and dignity toward the other person, then this healthy difference of opinion will allow for more meaningful debate and hopefully a better outcome for the company. Such an approach requires trust, and when it is done correctly, the company is able to benefit directly – directors will also benefit as they begin to understand their peers at a different level, not least also breaking the curse of superficial relationships.

Preventing board dysfunction

Boards and board meetings must have a strong, authentic leader with a clear agenda that makes them more productive, and through this approach assists the board to prevent various forms of board dysfunction. Indeed, whilst there are many variables which could cause a board to become dysfunctional, a number of preventative measures could be implemented to avoid this from occurring. Some of these measures may include:

- incorporate specific provisions in the company's MOI, Board Charter and policies (e.g. codes of conduct, conflicts of interest, delegation of authority);

- ensure a proper director selection process & benchmarking is in place;
- the board must emphasise an alignment with the company's value system (particularly in its recruitment of non-execs);
- restrict directors to serve on a limited number of boards;
- ensure there is the correct skill, experience and mix of directors on the board;
- conduct periodic board profile and skill set analysis;
- conduct timely board assessments (internal and external);
- use good governance procedures and understand the importance (significance) of a board and board meeting;
- disarm the board critic (overly disruptive director);
- set agreed annual goals;
- schedule time to review goals and update action plans;
- ensure continual communications and utilise social functions to build trust;
- build trust amongst members of the board and between the board and employees (avoid antagonistic atmosphere);
- conduct board induction / training across all jurisdictions;
- provide executive coaching and mentorship; and
- employ external advisors to diffuse excessive boardroom tension.



Whilst I have provided a number of measures for companies to consider -- in an effort to prevent boardroom dysfunction -- I wish to also state that a robust *Corporate Governance Framework® would greatly assist a company to deal with all of these issues, including the afore-mentioned factors. Whilst a Corporate Governance Framework® provides the board and each of its members a real-time dashboard of the company's mission critical components, it also allows directors the ability to interact with the company's executive and management levels in respect of any and all types of risk which may impact the company. Through a Corporate Governance Framework®, all the board members would have a better understanding of the business, and such which is devoid of any 'secrecy' or 'privileged information' matters.

Expectedly, access to this type of information -- namely that which covers all the key aspects and components of the business -- would enhance not only the director's own understanding of the business, but it would also go a long way to stimulate trust amongst the board and the board committee members. This is exactly in line with the King III tenants which state that the board of directors must have unrestricted access to all company information, records, and so forth.

Indeed, there is a strong argument which suggests that much dysfunction within a company may be caused not only because of a poor chairman or some of the other 'stimulants' which I have mentioned earlier, but it can also occur -- and in fact be exacerbated -- when the company has no central command framework which provides the board and management a central view of the company's overall health (i.e. traditional and non-traditional organisational risks).

As postulated by Patrick Lencioni that (MIS) TRUST is most likely one of the key ingredients that causes dysfunction, it stands to reason that if directors are not codified upon knowing where their accountability begins and ends, and similarly when management fail to understand their responsibility; dysfunction across the company is most likely to occur.

One of the quickest ways to debilitate a board -- and often this breeds mistrust amongst the executive and non-executive directors -- is when information is not forth-coming and / or complete. And whilst the independence of non-executive directors must be upheld, it is equally important that they not only receive reliable and sufficient information for their decision making, but also that they have a proper understanding of the business which they co-direct together with the executive directors. Accordingly, for the board to *believe* and *know* that it is a fully functional unit, all its directors must have sufficient high-level understanding of both the strategic and operational areas of the organisation, and these areas must be *directed in concert*. Without a Corporate Governance Framework® in place, this becomes almost impossible.

Conclusion

As I conclude this presentation, which will form the basis of further discussion by our esteemed panel of speakers; one has to ask whether a board would have become dysfunctional had the directors on the board actually done their work properly in the first place? They are the fiduciaries and they are expected by law, to protect the organisation. Despite various codes of good governance, including glossed-up directors' public reports and their espoused policies, many organisations and their company officers continue to misbehave in predictable ways, because their boards of directors have turned out to be nothing but ineffective watchdogs.

"… there are no bad organisations, only bad boards and it can be just one, or a few directors who may lead the organisation astray. Through their poor leadership and questionable governance practices immeasurable harm is brought to the organisation, including its exposed stakeholders."

Clearly this is not what is expected of a board, and organisations who are found guilty of "ethical lapses" and errant behaviour must be severely punished. So, in my opinion it is good governance when an organisation is punished by the market, to which the board is ultimately accountable. Three recent examples are:

- Pinnacle Holdings - nearly R1.5bn wiped off their market capitalisation due to an executive director allegedly being involved for bribery and possible insider trading violations
- VW - €8 billion put aside to cover costs of the crisis, and 20% drop in share price (€25 billion wiped off VW market value - ⅓ of its stock market value)
  - recall est. of 11 million vehicles worldwide
  - the €8bn excludes costs for litigation, fines or customer compensation
- MTN - fined $5.2 billion by Nigerian regulators (wiped off 20% off the company's market value)

The board has a legal and moral duty to ensure it is completely functional, and it must maintain such functionality if it is to claim that it is fulfilling its fiduciary responsibilities, as well as meeting shareholder expectations and averting legal quandaries. Further to this point, effective board directors are expected to have four basic qualities, namely, independence, expertise, bandwidth, and motivation. If directors do not have these traits, problems are bound to arise and it will be impossible for them to properly fulfil their oversight responsibilities. Research suggests that if a director has all four of these characteristics, then the company's likelihood of governance failure and / or board dysfunction will be greatly reduced.

It is befitting to end off this presentation with a quote extracted from the Public Protector, Advocate Thuli Madonsela's report entitled *"When Governance and Ethics Fail"*:

"*When governance and ethics fail, you get a dysfunctional organisation. Sadly those in charge cannot see that their situation is abnormal. That has been the case at the SABC for a long time…"* - Former member of the SABC Board (Source: "When Governance and Ethics Fail" Report of the Public Protector February 2014)

I thank you.

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