Board Reviews - Abort, Retry, Ignore, Fail – A New Model is Needed.

The chairman’s presentation at Diligent’s (DIL – NZX) 2013 AGM (June 23rd) included the following brief statement under the heading Strengthened Internal Controls: “The Board is currently undertaking a review of corporate governance matters with the assistance of an outside consultant, including with respect to the desired skill sets for the Board, share administration and other internal processes related to corporate governance.”

With this statement of the Chairman in mind, let us review what happened to the share price performance of Diligent in 2013. During the early half of 2013, the share price of Diligent rose significantly. On June 14th 2013, Diligent Shares were trading at $8 each; by December 16th 2013, the close price was $3.55. At the heart of this dramatic decline was not one, but continual disclosures, revealing poor oversight and governance by the board and executive of Diligent. Culminating in Diligent having to restate their financials and admit to breeches of NZX and NASDAQ regulations.

Were these issues directly attributable to individual directors or the board as a whole, or were the executive to blame? We may never know the answer to these questions. However, what we can determine, is that the rapid decline in stock value, and the stakeholder’s subsequent loss of trust and confidence in Diligent. Resulted from the poor performance of the combined board and executive.

Regrettably, Diligent is not alone, the performance of Volkswagen, Solid Energy, FIFA, The Blues Super Fifteen Franchise, NZ Swimming and nearly every finance company involved in the New Zealand financial crash (2008/2009), plus many other organisations. Have all suffered declines in performance because their board and executive team performed poorly.

Research and experience have identified that organisational performance is intrinsically linked to the performance of both the board and executive. The performance of one without the other is only half as good as the combination of the two. The board and executive teams are individually responsible, yet collectively accountable for organisational performance.

If we can accept that the combined board and executive, are the Team with the most influence over, and impact on organisational performance. Then shouldn’t we also accept, that understanding how the board and executive function as a team is imperative to enhancing organisational performance?

For clarity, when I use the word ‘executive’ it refers to the CEO and senior functional managers – for example, chief financial officer, operations manager, marketing manager – who have regular contact, formal and/or informal, with the board and/or individual directors. Including functional managers in a review process is even more important if the organisation has a managing/executive director.

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The rationale for including the executive and not just the CEO is straightforward. The executive is possibly the only group which can provide an external perspective on the board’s performance. Importantly, they are the best placed to identify how the performance of the board influences the organisation’s performance. Furthermore, including the executive provides a direct comparison between the board’s view of its effectiveness, which is generally overrated, and the reality, provided by the executive.

The significance of the board and executive having diverse views as to the board’s effectiveness is clear: these separate, yet intrinsically linked teams, are less likely to be able to work in synergy and have trust and confidence in each other. If the executive believes the board is ineffective. The outcome for an organisation whose board and executive have significantly divergent views on the effectiveness of the board will be, diminished levels of synergy, trust and confidence, and poorer organisational performance.

The presence and importance of the combined team: board and executive, was first identified in my research in 2011. This combined team was subsequently given the title of the “Third Team.” These three, but very distinct teams: board, executive and Third Team, form a trinity of leadership. While it is true that the board and executive team’s each has their own distinct roles and responsibilities. It is the Third Team that ultimately carries the responsibility for the performance, successes or failures that an organisation experiences. After all, it is the Third Team that discusses, formulates, agrees and action’s strategic and other decisions. The outcomes of which the Third Team are ultimately, mutually accountable for, or they should be.

It is accepted practice within organisations to review the board and in some cases the individual directors. The review process is seen as important to the board’s continued development and performance. Just as in the same way that reviewing the executive team, e.g. CEO, is considered to be. Surely then, if reviewing these teams’ individually is considered important, why do organisations ignore the importance of reviewing the most influential team in the trinity of leadership, the Third Team? Yet they do!

My research identified three core cultural qualities that all top-performing Third Teams have in common; these are: Synergy, Trust and Confidence. These qualities are all multi-faceted; that is, they are not attributable to an individual characteristic or attribute. They develop from the collective characteristics and attributes of the individuals within the Third Team, becoming the Third Team’s DNA. It is the Third Teams DNA which determines the levels of synergy, trust and confidence that exist between its members, and equally as important; it is this same DNA that facilitates the development of the Third Team’s cultural norms and values.

More importantly, they lack insight into the individual and collective characteristics and attributes, which are identified as being prerequisites for developing synergy, trust and confidence within the Third Team. Furthermore, current methods provide no insights as to the cultural norms and values of the Third Team.

1 Mowbray, D. P. (2012). Searching for the “mythical unicorn”- the missing link between boards of directors and organisational effectiveness.
More often than not, the currently popular methods of review only serve to impress the stakeholder with the idea that a great deal is being done, when, in reality, very little is intended to be done. Thereby ensuring that it is also quite harmless to the individual and collective egos of those involved, the directors.

In case, you may think I am dismissing the need to review compliance or policy aspects of the board, I am not. Measuring the conformance of the board with regulatory, policy or any other component of compliance is important. However, the outcomes from these forms of review are incapable of reflecting the current capability, nor, more importantly, can they reliably predict the possible future performance of the Third Team, and ultimately the organisation.

I have identified six elements that make the current processes utilised for reviewing the board and executive as separate teams and not as a collective ‘Third Team’ problematical:

1) The board’s collective preference for simplicity.
2) The boards general aversion to any measure that highlights dissonance and ambiguity,
3) Their deep-rooted belief that they operate in an orderly world, which is somehow, disconnected from the executive.
4) That no one, but them “truly understands what they do”
5) That the level of secrecy surrounding board reviews and their outcomes damages the trust and confidence that all stakeholders (including the executive) have in the process.
6) There is a general lack of understanding of the importance, impact and influence that the collective and individual characteristics and attributes of the third team have on organisational performance.

The use of a closeted board review process is at best a dereliction of the board’s duty to test the board’s effectiveness and performance. At worst, it is an indicator of the board’s disconnection from the reality of their role and responsibilities in the life of the organisation they have been entrusted to govern.

1. Do directors enjoy working in a cognitively challenging environment?
2. Is the board’s intellectual capital, which consists of: human capital, social capital [internal and external], cultural capital and structural capital, consistent with that of the executive and matches that of the organisation?
3. Does the executive make use of the tacit knowledge of the directors through the replication, innovation or adaptation of this knowledge?
4. What is the state of the board–executive relationship?
5. What is the level of disparity between the board’s and executive’s view of the board’s effectiveness?

It has been shown that where a third team performs poorly across these five primary themes, three outcomes follow,

a) There is a lack of synergy, trust and confidence within the Third Team.
b) The Third Team’s cultural norms and values are ill-defined, resulting in a poor or inappropriate organisational culture.
c) Organisational performance declines across a range of metrics, e.g. financial performance, risk analysis, strategy, and succession planning.

The use of my methodology allows organisations to develop a profile of their Third Team’s behavioural governance. This behavioural governance profile provides the basis on which the Third Team can review how its performance is influencing and impacting the performance of the organisation. The profile facilitates this, by enabling the Third Team to identify its weaknesses and/or strengths and put in place remedial actions. Furthermore, the behavioural governance profile provides the opportunity to develop and enhance the skills and functionality of the Third Team. Thereby, empowering the Third Team, to drive their organisation’s performance in a collaborative and mutually accountable way. And surely that’s what reviews are meant to achieve?

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