Boards, keep your eye on culture, people and incentives

That do you do if you see a fire in your living room? Most people, certainly, would run to the smoke alarm system or alert others. And, most importantly, to the fire extinguisher, discharge it on the source of the fire, while yelling orders to whomever might be within earshot! “Get Out! Call the fire department! Do this! Do that!” In a pinch, we all become firefighters … even if it’s just a smoke alarm system.

Corporate board members tend to be no different. The mindset that the company may have a full and well-trained firefighting squad, never mind all the thoughtfully-developed and well-tested contingency plans, in all likelihood, most board members feel compelled to take charge, and many do. But enough of the firefighting analogy.

Boards of directors of companies have certain duties, including the well-established Duty of Care, a key component of the Fiduciary Duty. The Duty of Care demands of directors that they be engaged, well-informed, prepared before board meetings, attentive during board meetings, generally knowledgeable about the affairs of the corporation, and thoughtful and deliberate when making important decisions.

When faced with momentous decisions, however, boards are sometimes prone to forget that their primary function is one of oversight, and not management, and certainly not micro-management. The company’s management team is tasked with running the company, while the board is tasked with oversight of the corporation. When boards micromanage, they have a great and dangerous tendency to try to question and influence the things that they see, while ignoring the unseen. Boards generally don’t know that the management team plans, and that may well include important drivers of managerial decisions. One can question, and try to influence, why the board of BP was even aware of the actual decisions being made on a day-to-day and hour-by-hour basis on the team on the ground – or rather at sea – during the hours leading to the Deepwater Horizon disaster in the Gulf of Mexico. In all likelihood, the board was completely in the dark about the unfolding events until the well exploded and 11 workers lost their lives.

Consider another high profile disaster – the case of Transmile Group Bhd – where the board was quite reputable on paper, but missed the important fact that the management team plan was actually engaged in active wrongdoing. The senior managers who were actively conspiring to defraud the corporation were most probably unseen by the board, and it is hard to conceive, no matter the level of engagement of the board, how the board members might have figured out what those executives were up to before the board became full-blown and widely known.

Does this mean that boards are doomed to be of limited value, and should therefore not even try to steer the corporation in the right direction? Absolutely not! On the contrary, I do believe that boards are uniquely well-placed to steer the corporation in the right direction, and avoid the kind of damaging behaviours we discuss above. To see how, one must have done just about anything to avoid being entangled in their respective corporate scandals. Our conclusion is that precious few directors in these companies kept an eye on the three wrong things once or even twice, and in their way out of a crisis. By the time the crisis had erupted in such companies, however, it was too late to begin to make a difference. The time to intervene is long before the crisis strikes. Prevention is the name of the game. Or at least it should be.

Boards of directors cannot realistically dictate behaviours. All it takes is one or two or three bad apples in reasonably high position to destroy a large and otherwise promising company. Give the bad apples a few poorly conceived incentives, and say the wrong thing once or even twice. Or at least it should be.

Or try futilely to micromanage their way out of a crisis. By the time the crisis had erupted in such companies, however, it was too late for the board to make a difference.

If your company has a culture of “Everything Goes,” then, if your CEO orders “We’ve got to make the numbers,” well, he is more likely to be understood to be saying, “I don’t care how you do it, just don’t miss the forecast!” Cutting corners? Well, that may be seen as the cost of doing business. Pushing the limits of accounting standards? Well, anything short of breaking them may be seen as a badge of honour. Start on such a path, and your company finds itself on a slippery slope which very often ends in unmitigated disaster.

On the other hand, if your company’s culture is clearly and unequivocally one that values, recognises, and rewards hard work, value creation, and responsible and ethical behaviour, and one that always acts to preserve its reputation, then, well, someone says: “We’ve got to make the numbers,” it will be well understood that we don’t ever jeopardise our reputation. Yes, we work as hard as humanly possible to make the numbers, but “cooking the numbers”? That just never enters our collective mind! This company just doesn’t do that.

Culture is one of those overused words and concepts. What do we mean when we say that we want to have the “right culture”? One of the best and most succinct definitions of culture that I have come across is “the way we do things around here”. Culture is a way of life. It is a value system. You recognise it when you see it. But culture isn’t just born, nor is it self-sustaining. Culture needs to be nurtured. Behaviours that are reflective of the desired culture need to be recognised and rewarded. The board and the CEO also need to commit themselves to communicating the culture. Building and communicating the right culture can make your company resilient and possibly immune to external negative pressures.

When it comes to “people”, it’s all about recruiting, training, and rewarding the right behaviours. The tie to the proper culture should not be difficult to discern.

And finally, when it comes to “centres”, remember that KPIs have a dual objective: everyone may recognise that your management team’s KPIs are meant to measure their performance and determine their compensation, but remember also that KPIs are a powerful and concrete way to communicate your company’s strategy as well as your values. So, when deciding on KPIs, look for consistency with the culture you are trying to create and reinforce. To repeat, KPIs are not just for compensation setting, rather, they are a tool for the board to reinforce the culture it wishes to support, and the behaviours it expects. If your company hasn’t recruited the right people, if your culture isn’t what you want it to be, and if your incentive systems are encouraging the wrong behaviours, act now, before you find yourself and your company in the midst of a crisis. By then, events will shape you and your legacy, and chances are you will have little influence on the outcome. Act now and you will find that by shaping the company’s culture, people, and incentives, the board can make an enormous difference without overstepping its bounds and while allowing a competent management team to create value.

In short, boards, forget about trying to micromanage your organisations! It is far more effective to make sure you have the right culture, people, and incentives. Recognise that. Communicate it. Express pride in it. You will be more than halfway there, wherever “there” is for you.