What Should Boards And CEOs Do To Prevent Institutional Failures

Outline of Presentation By Prof Stephen Adei, PhD, OV

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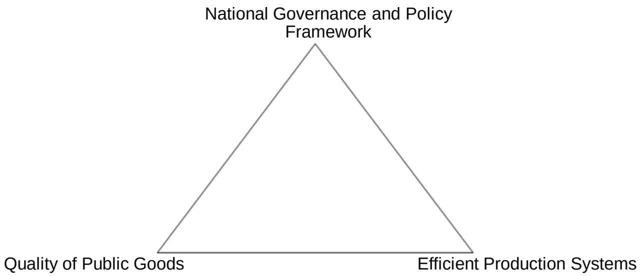
AFRICAN FEDERATION OF INSTITUTES OF INTERNAL AUDITORS

The Institute of Internal Auditors GHANA

THREE LEADERSHIP UNFORGETABLES

- "Leadership is cause, everything else is effect" (S. Adei)
- "The fish rots from the head" (Bob Garatt)
- Integrity: 'Slightly soiled, greatly reduced' (Anonymous)

COORDINATES OF THE WEALTH OF NATIONS



Adei's Model of National Development , 2004

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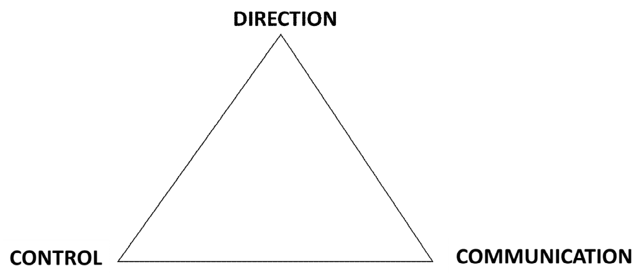
THE PERVASIVE ROLES OF BOARDS AND CEOs

- In each domain, irrespective of the nomenclature, CEOs and Boards constitute the linchpin
- Institutions rise and fall with them
- Where they compromise their fiduciary and other responsibilities, institutional failure occurs
- When they are competent, ethical, have in place effective systems and manage risks effectively, success is assured

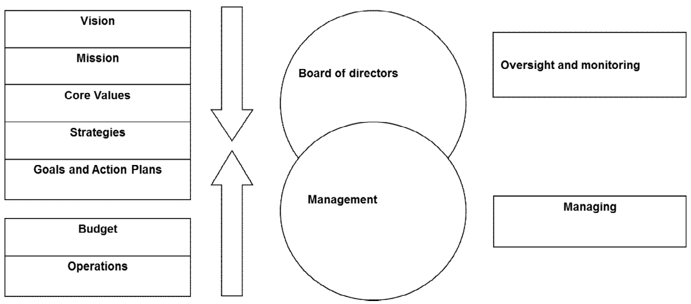
WHAT IT TAKES FOR BOARDS TO BE EFFECTIVE

- **Legitimacy** – The legal/regulatory dimension
  - Respect of articles of association or law of incorporation
  - Operation within regulatory framework
- **Competence** – Capacity of board members in discharging their functions
  - Your ability to deliver (intellectual skills, independent thinking, knowledge of business etc.)
  - Application of oneself (preparation)
- **Trust-** fiduciary responsibilities
  - Duties of due care, loyalty, good faith; to exercise diligence, independent judgment.
  - Avoid conflict of interests
- **Ethics-** moral and social responsibility
  - Integrity, values, transparency, accountability, probity, and respect of the rights of all individuals(Garratt 2003)

WHAT DO BOARDS DO?



RELATIVE DOMAINS OF BOARD AND CEO



FOUNDATIONS OF EFFECTIVE BOARD-CEO RELATIONSHIP

- Clear Understanding of Relative Roles, Authorities and Influence
- Makes or Breaks effective CG
- Clear understanding and respect of rules of the Game (Company law, regulatory framework, activities toward mandate etc.)
- Ensuring standards and norms and robust performance and risk management systems are in place, monitored, evaluated and followed
- Confronting cultural baggage in Africa
- Integrity, integrity, integrity (Fiduciary issues)
- Working towards a strategic/operational agenda

GOOD CORPORATE BOARD IN PRACTICE

(1) Open an engaging boardroom atmosphere

(2) Maximization of the value of the board's time commitment by establishing clear roles and responsibilities within an appropriate structure

(3) Determination of the information the board needs and ensuring it is delivered in a timely manner

(4) Dedicated time to strategic issues

GOOD CORPORATE BOARD IN PRACTICE cont'd

(5) Having a transparent, explicit, and accountable executive pay process

(6) Active engagement in CEO and succession planning

(7) Assessment of the strength of the company's management talent

(8) Monitoring the companies enterprise risk management system

(SOURCE: http://www.google.com.gh/url Corporate Governance And Ethics Chapter Iv By Zabihoila Rezaee)

INSTITUTIONAL FAILURES IN RECENT TIMES

- Institutional failures are part of economic development
- The emergence of TNCs has greatly enhanced their impact
- Corporate failures like Enron, WorldCom, Tyco of early 2000s and the financial crisis of 2008/2009 were unprecedented in magnitude and underlying management and board failures etc.
- Emerging and developing economies including Ghana (e.g. Ghana Airways) have their fair share of institutional failures which do not attract world press

WHY INSTITUTIONS FAIL

While causes of institutional failure may be as varied as organizations, the literature on institutional failures may be summed up as follows:

- Leadership Capacity (competence of Boards and CEOs)
- Legal, gatekeepers and regulatory weaknesses and failures
- Weak risk management systems, monitoring and implementation
- In developing countries, environmental factors (national economic mismanagement, political interference, weak governance and public goods *a la "dumsor"* and cultural factors especially work ethic)
- Fiduciary issues (due care, loyalty, good faith, exercise of diligence, independent judgement, conflict of interest, transparency, accountability, values and above all integrity)

FOUR KEY PLAYERS IN PREVENTION OF CORPORATE FAILURES

- **First Shareholders**: passivity and greed of many shareholders today contribute to institutional failures as they look for short term gains thus encouraging inordinate risks and not actively scrutinizing the behaviour of corporate managers and boards. Especially institutional shareholders and investors in big corporations such as pension funds, mutual funds, banks, life insurance companies must be more active in monitoring corporate misconduct to protect their investments. The same goes for major shareholders in smaller companies

FOUR KEY PLAYERS IN PREVENTION OF CORPORATE FAILURES- cont'd

- **Second gatekeepers**: e.g. central banks, securities and exchange commissions, credit rating agencies where they exist, external auditors, and of course the state play important role in ensuring laws, rules, regulations, processes and procedures are more rigorous and respected. Gatekeepers must act in the interest of investors and shareholders and not to be in bed with executive management and boards

FOUR KEY PLAYERS IN PREVENTION OF CORPORATE FAILURES- cont'd

- **Third, Boards of Institutions and Corporations:** The Board "allowed Enron to engage in high risk accounting, inappropriate conflict of interest transactions, extensive undisclosed of—the– books activities, inappropriate public disclosure and excessive compensation" (Edwards, 2003)
- **Fourth, Executive Management:** Corporate managers managerial competence, fiduciary responsibilities etc. constitutes another major if not the key factor in corporate failures
- **As Peter Cebon (HBR January 16, 2017)** company crises invariably relate to collapse of competence, shortcomings of self governance and inadequate corporate governance

WHAT SHOULD BOARDS DO TO PREVENT INSTITUTIONAL FAILURES?

- The single most important job of the board is appointment of competent CEO of integrity, monitoring and evaluating performance and supporting the one to increase shareholder value
- Second, ensuring their own competence in delivering the functions of the board namely direction, control and communication
- Third, putting in place a robust performance, reporting and risk management system with sufficient early warning signs and acting on them
- Fourth, ensuring that executive compensation relates more to corporate strategy and long term sustainability of the institution as opposed to short term excessive risk taking
- Fifth, taking due care of their fiduciary responsibilities to represent interest of shareholders effectively especially avoiding conflict of interests, succumbing to go along collegial atmosphere and being in bed with executive management
- Sixth, assuring that the gatekeepers especially internal and external auditors provide independent and reliable confirmation of executive performance

WHAT SHOULD CEOs DO TO PREVENT INSTITUTIONAL FAILURES?

- CEOs owe corporations and their shareholders two major responsibilities namely efficient management and integrity in delivering fiduciary duties to the board and shareholders. Failure in either of them, and unchecked by the board ultimately leads to institutional failure
- negatively, executive managers should not be "motivated by self aggrandisement than by a desire to benefit the corporation and its owners" (Edwards, 2003)
- The third is engaging experts with regards to problems beyond their capabilities
- Fourth, putting in place mechanisms that allow those working under them to be bold to raise red flags to him/her

THE ROLE OF INTERNAL AND EXTERNAL AUDITORS

- I always say "Nobody steals government money alone". By extension, I will say internal and external auditors ultimately get to know about factors leading to corporate failures long before anybody and their acquiescence, lack of knowledge, training and experience needed to detect fraud or at worst their active participation is a major contributory factor to institutional failure
- Independent, empowered internal auditors of integrity is key to prevention of institutional failure

"SLIGHTLY SOILED GREATLY REDUCED"

- Institutions like Enron on the surface seem to have gotten everything right, robust structures, competent and sufficient independent board members etc. what was missing was integrity of the key players especially the CEO, Board Members and Auditors
- Laws, regulations, qualified CEOs and ostensibly good boards without values and integrity will not stop institutional failures.

I THANK YOU