

Six boardroom dysfunctions every board should guard against

KPMG Board Leadership Centre

Randall S. Peterson, Professor of Organisational Behaviour; Academic Director, Leadership Institute at London Business School, joined our Board Leadership Centre to talk about six boardroom dysfunctions every board should guard against: lack of independence from management; missing key voices; cultural amplification; diffusion of responsibility, rule-bound cultures; and groupthink. This extract from his book, 'Disaster in the Boardroom: Six Dysfunctions Everyone Should Understand', co-authored with Gerry Brown, sums up Randall's presentation and the ensuing discussion.

Where was the board? This is the cry that emerges among investors and in the financial press each time a company disastrously collapses or becomes enmeshed in a scandal. The board of directors are, in principle, the guardians of the company, the people who ensure it is well-managed, financially secure and operates in the best interests of its shareholders and, increasingly, other stakeholders. Yet, time after time, when companies come crashing to the ground, it emerges that the board has failed in its fiduciary duty; to the organisation, to ensure it is managed responsibly and sustainably, and to all stakeholders including shareholders, to ensure their interests are not harmed.

Sometimes this is out of ignorance. In the aftermath, it emerges that the board literally had no idea what was going on inside the company for which it was supposedly responsible. Even when worrying signals were detected, the board failed to develop a complete picture of what was happening. 'Asleep at the wheel' is the phrase one regulator used to describe a singularly inept board. In other cases, members of the board were knowingly complicit in what was happening, turning a blind eye to financial irregularities, sexual harassment and assault, unsafe working conditions and a host of other abuses. Ignorant or criminal; that is often the choice, and it is hard to know which is worse.

The damning indictment of our systems of corporate governance around the world is that there is nothing new about this. Scandals, collapses and bankruptcies have been going on for centuries. Over the course of time, we have learned a great deal about how and why they happen, yet they still happen with shocking regularity. Indeed, some people simply shrug and accept these things as transaction costs, an unavoidable part of the system that nonetheless has produced incredible wealth around the globe.

But it should not be this way. We should not, as Adam Dixon argues in *The New Geography of Capitalism*, grow blasé about the scandals that rock economies and societies and cause enormous suffering and hardship all around the world.

We should not tolerate abuses of power by toxic executive teams, CEOs and chairs; nor should we tolerate the failures of those who are ineffective. We should be holding those responsible for corporate failures to account and making changes to prevent these boardroom disasters from happening in the future. Now, more than ever in the aftermath of the global pandemic that has put hundreds of millions out of work, destroyed thousands of companies and brought entire economies to their knees, we need to have proper governance. Boards must improve and take responsibility. If they fail to do so, our chances of economic recovery and achieving prosperity will be vanishingly small.

Pandemic reality

The Covid-19 pandemic of 2020 exposed many weaknesses and failures of governance in a cruel and unforgiving manner. Around the world, tens of millions of jobs were lost and hardship and inequality increased as businesses and other institutions tried and failed to cope with the effects of the pandemic. The World Health Organization had been warning of the dangers of a pandemic for years – in the UK alone, major scientific reports in 2016 and 2018 had highlighted the risks and consequences – and previous epidemics such as SARS, MERS, Ebola and swine flu had shown on a local level the damage that disease could cause. In other words, we knew a pandemic was coming and the only open question was not if, but when. We also knew it would have a massive impact on business and society.

Even so, governments and corporations around the world were caught unprepared. A few larger organisations had pandemic plans ready to be put into place, but these were the exceptions. Most organisations had no business continuity plans; most had not even considered a pandemic as a risk worth evaluating.

In fairness, this probably will not happen again. We can expect that business continuity plans, pandemic insurance and all the other measures that should have been put in place will now be there. But we are entitled to ask questions – not just of our governments but of all organisations – why the warnings were ignored and why we were so unprepared. We can say two things for certain about the pandemic. The first is that the failure to prepare for it has been a colossal failure of risk management. The second is that the consequences of that failure in terms of economic damage and physical and mental health problems will be with us for many years to come.

Dysfunctional boards

So why have we tolerated this near-perpetual crisis in governance for so long? There are two related problems. The first is widespread ignorance within society – including some sections of the media – about the role of boards and the impact they have on our everyday lives. What do boards do? What do chairs do? Many people, including a startling number of board members themselves, do not know, and not enough effort has been made to bring this issue to the public's attention. To some, the role of the board is scrutiny and challenge, holding the executives to account and intervening when things go wrong. To others, the board's purpose is to support the executive, gathering resources and processing information to help the company make better decisions about strategy and risk. In fact, the role encompasses both of these things, and much else besides. What often gets forgotten is that boards are the stewards of the organisation, responsible for ensuring it is run wisely and well, and that it functions in the best interests of its stakeholders.

Board culture

Dig more deeply into why boards hire dysfunctional CEOs and you'll find that the real underlying problem is the culture of boards themselves. The culture has a powerful role in determining what happens, not just within the board itself but across the organisation and its ecosystem. Losing control of board culture – or worse, failing to establish an effective boardroom culture in the first place – is akin to opening Pandora's box. Once events begin to spiral out of control, it is very difficult to recover. Corporate disasters are not the problem in and of themselves; they are symptoms of a deeper cultural dysfunction that often has its roots at the board level, or at the very least are the responsibility of the board.

When we speak of 'board culture', we are talking about three things. The first is the shared values, beliefs, mindsets and attitudes of board members, and the way people interact, especially the independent directors and the chair. Gone are the days when independent directors attended board meetings once a quarter and enjoyed a free lunch.

Today they are expected to play a vital role in corporate governance and are expected to commit to the organisations they govern, to be both impartial judges and strong supporters, coaches and referees.

Things have improved over the past 30 years, but not enough. However, given the steady stream of disasters we continue to see, we still have to question whether many independent directors have the mindset, experience, knowledge and skills to ask the important questions and help the organisation make effective decisions.

Second, the board is also the custodian of the wider organisation's culture. It is the board that decides what the organisational culture should be, not the other way around. If a toxic organisational culture begins to seep into the board culture, the organisation as a whole is at greater risk because board priorities and practices will flow into the organisation via the top management team.

The third element of board culture is the ability of the board collectively to assert its independence and avoid being dominated by overly powerful individual executives or shareholders. That means that, as well as having the right people on the board, the board itself has to be structured in such a way that everyone has equal freedom to speak and express their views and vested interests do not dominate the board. Independence, then, is something that needs to be in place at both a personal and a group level. The directors must lead by being independent and able to challenge the executive, and so too must the board as a whole.

When all these things come together, when the board has a strong culture of its own based on the values of independence and with a finger firmly on the pulse of the wider organisational culture, then companies can weather disasters; even ones that are not of their own making.

Types of dysfunction

Research has identified six different types of board dysfunction: lack of independence from management, missing key voices, cultural amplification, diffusion of responsibility, rulebound cultures and groupthink. Each manifests itself in a particular type of board behaviour:

1. Subordinated boards – lack of independence
2. Imbalanced boards – missing key voices
3. Distended boards – cultural amplification
4. Bystander boards – diffusion of responsibility
5. Bureaucratic boards – rule-bound cultures
6. Conforming boards – groupthink, focus on agreeing more than making good decisions

Of course, dysfunctional boards rarely exhibit just one of these behaviours. Two or more dysfunctions often work at the same time and some dysfunctions tend to breed others.

The subordinated board is unable or unwilling to be independent from management. It is vital that the board is independent of the executive and is able to take an objective view and make enforceable decisions.

The executive will generally have a bias in favour of actions the company has already taken, and this is particularly true during a crisis. This is perfectly natural; in most cases, they will have taken decisions for what they believed to be valid reasons, based on what they regard as reliable evidence. But there needs to be a system of checks and balances whereby these decisions are scrutinised and questioned as necessary. Most of all, the board needs to keep its eye on the longer term and develop and support a sustainable strategy to help the organisation meet its goals. A key cultural dysfunction occurs when the board cannot separate itself from the executive in order to critically examine what is before it.

The imbalanced board is missing key voices, often as a result of lack of engagement with a full range of stakeholders. Diversity of background, thought, experience and knowledge are vital at board level. If they are not present, decisions are made without the benefit of a range of perspectives and experience. The less diverse the board is, the less likely it is to understand when key viewpoints are absent. Homogenous boards tend to make decisions that are not fully informed (ie, by the missing voices).

The distended board suffers from amplification of culture. In this scenario, the existing culture intensifies so much that it becomes dysfunctional or misdirected. This is a particular problem where an organisation has 'outgrown' its original culture, yet clings to a system that is no longer working. Start-ups, for example, often benefit from a dynamic and aggressive culture that focuses attention on getting through the problems of establishment and early growth, but studies of entrepreneurship have shown how this culture needs to change and mature with time. As many companies and organisations have discovered, the road to hell is paved with good intentions and the hard-working, get-the-job-done culture they thought they had at the beginning has turned into something dark and toxic with the passage of time.

The bystander board is characterised by diffusion of responsibility. Here, the cultural dysfunction takes the form of abdication of responsibility by some individuals, or even the board as a whole. Key players point at one another and collective ownership of major problems is absent. Weak board relationships – for example, the presence of a large number of new board members who have not yet had time to get to know and trust each other – and/or a weak or inexperienced chair can be among the causes of the problem. Boards need to act collectively and communicate with a single voice.

This does not preclude dispute and debate in private before a decision is made; far from it, but these discussions need to be brought to a resolution so that boards think and act with one voice.

The bureaucratic board suffers from an overly controlled culture. While processes and rules are critical to a board's ability to operate, the focus on these can sometimes be so strong that additional information that falls outside the usual channels or systems is collectively ignored or disregarded. This risk is especially present when a board is wedded to processes it knows and is comfortable with. There are two problems here. The first is confirmation bias: if the information placed before the board is in line with prior expectations, no one is going to challenge it or make waves and it confirms expectations.

The second problem is the optimism bias: when information is received that contradicts received wisdom, boards find reasons to exclude it from decision making. The problem is particularly acute when there is a lack of independent scrutiny from the board.

As noted above, boards need to take collective responsibility, but sometimes the desire for harmony and 'smooth' decision making can lead to an overly strong bias in favour of consensus; alas, **the confirming board**. Board members are less likely to raise controversial points or 'rock the boat' if their peers seem otherwise in agreement; no one wants to be the lone voice of dissent and question the process or any idea being debated.

What can be done?

There is an urgent need to change and reform board culture. Actually, there is a role for each and every one of us; there needs to be more and better education for directors and chairs, and regulatory bodies need to take prompt and firmer steps to discipline weak boards, before they fail. But, most of all, boards need to change themselves.

The world is getting increasingly complex and boards need to rise to this challenge. At the moment we face a series of interlocking crises: the aftermath of the pandemic, a fragile and deeply damaged economy, rising inequality and hardship, the climate emergency. In 10 years' time, there will be more complex problems, not less. We need solutions to the problems these crises pose before the situation gets even tougher. Now more than ever, good governance is absolutely vital. But we are not getting it. Something is broken. We need, urgently, to fix it.

Questions directors should be asking – not just once, but repeatedly throughout their careers

Lack of independence from management

- Do you ever seek advice from outside of the executive team, either within the organisation or externally?
- When facing crises or major problems, do you distinguish between the executive and the independent directors?
- Are the independent directors seen as an important resource in helping to make difficult decisions, or are they expected to rubber stamp whatever the executive puts before them?

Missing key voices

- Is your organisation the subject of a social media campaign or protests? Are any protests being discussed in the boardroom, or are they being pushed aside?
- Is there anyone representing the voice of the dissenters around the boardroom table?
- Have you looked at employee turnover by diversity category? If it is uneven, that's a sign that the board may be missing key voices.

Cultural amplification

- Would you tell your 'war stories' about what goes on in your organisation to your friends and family? Or would you keep silent because they 'would not understand'?
- Do you have to explain your organisation's culture to other people in order for them to understand what is happening to you?

Diffusion of responsibility

- Is the board monitoring how things happen in addition to what happens? How is at least as important as what.
- Do you feel uncomfortable when someone else on the board says or does something embarrassing?
- If not, are you taking enough responsibility? Remember, boards need to speak to the world with a unified voice, so if someone says something that turns out to be incorrect, it reflects poorly on you.
- Do you pretty much always require a formal vote on key issues?

Rule-bound cultures

- When a crisis hits, do you focus first on process or content?
- How difficult is it to challenge or change the process? Are there generalised customs concerning who needs to sign onto what, or are there specified processes/formulas?

Groupthink

- Do you feel under pressure to agree constantly with the rest of the board?
- Do you hold back from speaking your mind?
- Do you go along with the majority in public, while secretly wishing you were able to visibly disagree? Or do you feel that if everyone else has taken a position, it is your duty to go along with them and not make waves?
- Are you challenging people at the right time?

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The KPMG Board Leadership Centre

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