The Role of Directors During the Downturn

In its Annual report on economy, the International Bank for Settlement says "The current market turmoil in the world's main financial centres is without precedent in the postwar period. With a significant risk of recession in the US, compounded by sharply rising inflation in many countries, fears are building that the global economy might be at some kind of tipping point. These fears are not ground".

In its lead article on "Britain's sinking economy", the Economist says "It is going to get nasty; exactly how bad depends on Bank of England and Gordon Brown". It all started with the run on the banks like Northern Rock spreading to the fears of crash of the housing market, stagflation and the weakening pound. A country that once stood proudly apart from the rest of Europe, trumpeting its "Third Way" to prosperity, is having serious doubts about its own policies and has started pillorying its own prime minister, at one stage regarded as the best ever British Chancellor of the Exchequer.

The doom and gloom is so widespread that both the developed and emerging markets are suffering from it. Increasing inflation and high cost of debt are killing the companies. Most companies have started cost cutting programmes. Ford has stopped production of their suvs and is moving full throttle to smaller cars. Toyota has unveiled its remodeled Crown Sedan under its latest cost cutting drive to effect savings of $2.8 billion.

These are tougher times for company boards. More so because only last year it seemed that good times were going to last for ever. Business seemed to have entered the best of all possible worlds - low inflation and high growth were powered by advanced technology and inexhaustible markets that were generating, and would go on generating, unprecedented rises in productivity. Banks like Barclays, and stores like Marks and Spencer had generated record profits. Building societies were flushed with money and touting public for mortgage bonanzas as if there was no tomorrow. The city was crowing about being the world's largest financial capital, thanks to the less stringent listing requirements of the London Stock Exchange. There was a revulsion against Sarbanes Oxley as if it were the kiss of death. It was decimating NYSE and SEC was making cacophonous noises how they were rolling it back. UK was priding itself on its pragmatic and pliable financial regulatory system "comply and explain" unmindful of the excesses of the hedge funds.

"How," asks the report of the International Bank for Settlement, "could a huge shadow banking system emerge without provoking clear statements of official concern?" How, indeed could lending frenzy be so widespread that even conventional banks hooked on toxic substances such as MBSs and CDOs were lending without a thought about the solvency of the borrowers. The result is that even after the blighting of the money markets for almost a year none knows who owes whom and what.

It begs the question how could the boards of these institutions, supposed to monitor performances, missed such egregious failures? Charles Elson, who sits on several boards and heads the Corporate Governance Centre at the University of Delaware asks: "Where exactly were they when all this was going on?" The question is beginning to be asked by shareholders and employees whose lives have been destroyed by these market manipulators.

Success is its own enemy

One of the laws of old economy is that success breeds excess. Unless the excesses are corrected, the success turns its own enemy. The longer the boom, and the larger the bubble, the sharper and deeper is the eventual fall. Continued high profits and sales blind management – the classic IBM syndrome - to the fierce reality: their underlying strengths are diminishing. When the impact of this deterioration fully breaks through, it's usually too late to undo the damage. Abundant cash flow and high morale of peak performance turns into tightening and downsizing of the finances in a forlorn effort to restore company fortunes leading the company to further doom and gloom and an all around demoralisation.

Britain's is a classic example of success followed by hubris followed by complacency and atrophy. Economic growth was buoyed in recent years as the City thrived on the back of all the clever financial deals that have now got unstuck. The excessive hedge fund operations made it vulnerable to an extended banking crisis. The era of GDP growth supercharged by borrowing could not last. Companies who grew rich on cheap borrowed money will have to learn new skills to survive.

The current debacle of capital markets despite regulation

The current debacle of capital markets is fuelled by the greed of bankers, financial institutions and the monied class. The shenanigans that followed the collapse of Bear Stearns showed crass behaviour of market manipulators that have spelt doom of the global free-market capitalism. This has made the debate about easing regulation following the 'overkill' of Sarbanes Oxley Act irrelevant. It has made the attempts of far too many regulators competing with each other to deregulate the financial system in a race to the bottom farcical.

The unique spectacle of impending recession coupled with rising inflation produced by one of the most reckless manipulations of capital markets with the connivance of regulators has catastrophic implications. Billions of dollars in shareholder value has been wiped away. Stunned Bear Stearns shareholders have seen their investments virtually wiped out overnight. The takeover deal with J P Morgan Chase offered $2.4 a share compared with Bear's $159 stock price in April 2007.

Questions abound on the buyout. Shareholders, law makers and public at large want answers on how the deal was arranged, and gained government approval and financing, all in a few hours, and seemingly without alternative bidders being canvassed.

Insider trading on Wall Street is starting to look as troubling as it was in the time of Ivan Bosky in the 1980s, the head of enforcement at the US Securities and Exchange Commission warned recently. Linda Chatman Thomsen, the SEC's director of enforcement, said she had been "quite dismayed" at the nature of the commission's recent insider dealing actions.

"The tippers and tippees have been in senior positions of trust and confidence," she said. "We are far from low-level employees or people on Main Street." Ms Thomsen expressed concern at the "multiple incidences" of insider trading and cases involving couples who were both professionals. Recently a former Ernst & Young partner was charged with allegedly passing insider trading information to an investment banker friend ahead of seven deals involving the accounting firm's clients. In one of the most high-profile cases recently, 13 people, including a Morgan Stanley compliance officer and a UBS executive director, were charged in relation to an insider trading scheme.

That all this should happen despite the draconian Sarbanes Oxley Act points to the abyss reached by the free-market capitalism and the flagrant disregard of all norms of corporate governance practices and risk management standards.

Beating the Competition in the Economy of Surprise

The basic reason for this credit crunch is that our financial analysts could not see the change coming and never made contingency plans. They did not learn any lesson from Enron, WorldCom or Tyco. They never considered the impact of Iraq war, the increasing annual deficits of US putting steady pressure on the dollar, the jingoism of George Bush, impact of climate change and increasing energy demands of the emerging economic giants – China and India. So drunk were they on their fancy financial instruments that they did not exercise even the basic caution of hedging their bets about oil going up, commodities soaring and dollar going down. They ignored the basic character of today's economy. The result is that the perpetrators of these excesses became the victims of their own crimes. As a consequence the heads of five of the world's biggest investment funds lost $2.2 billion of their personal wealth since the peak of 2007. The wealth of James Cayne , the CEO of Bear Stearn reduced to about 5%. Richard Fuld of Lehman Brothers lost about 80%. The shares of John Mack of Morgan Stanley and of John Thain of Merryl Lynch lost by half and Lloyd Blankfein lost about 30% of his wealth.

We are living today in the economy of surprise and contradictions. The headlines in today's paper say "SBI beats forecast with profit growth of 15% and ICICI net dips". A sleeping elephant rises despite financial

gloom and a bank known for its spectacular efficiency and customer service fails the expectations of its shareholders.

In the past companies have been using following management tricks to beat the competition:

- flat structures and bottom-up decision-making;
- strategic alliances with suppliers, customers and competitors;
- outsourcing and direct participation in emerging markets
- establishing multi-media ‘contact centres’
- interaction over active websites, blogs and e-mail
- optimising the efficiency of the entire, end-to-end business system

These strategies are increasingly reaping the law of diminishing returns because the competitors have commoditised these initiatives. Survival today depends on the speed of surprises a company can create for the competition in this economy of change and surprise? The time for 10% staff cuts and 20% quality improvement is past. In this wrenching and ruthless change the only competitive space comes from using the violent and accelerating change viewed by opponents as a problem as grist to power your engine of innovation.

In this warpspeed economy the directors – independent or executive - can no longer stay as silent spectators or watchdogs. They have too much to lose. Inaction could land them in jail. Society’s expectations of directors contribution is way beyond their potential. They expect directors to deliver exceptional output or become output themselves. To fulfill their expected role directors have to become transformational leaders. They have to be wise enough to realise the utter futility of remaining ineffective independent directors. Make no mistake. All these banks and financial institutions went down despite having brilliant independent directors just as ENRON and Worldcom did. It is time we realised the limitations of independent directors. It has been established that independent directors who don’t have a stake in the company whose board they adorn, are not the most effective watchdogs. Board meetings are often so brief and infrequent they have little chance to create an impact of any sort.

The irony is that these firms who have been consigned to the dustbins of history also had the best management advisors. McKinsey continues to be the consultants to 75% of the world’s top 200 companies. No wonder these companies become over managed and under led. We want to turn every director into a leader. We want them to become proactive enough to get themselves elected in key committees such as the audit or remuneration committee. This means they have to re-create themselves. This has to become an inside out job. They have to lead from the front. This needs re-training. Just as Gandhi did. Gandhi, a master communicator, admits to not being able to utter a word at his first encounter with a small cause court judge. But he said later: “I persevered and I persevered and I persevered. I can now give a certificate to myself that a thoughtless word has neither escaped my pen nor my tongue”.

Sylvester Stallone recreated himself when he returned to films after a long absence. Al Gore did that after he lost to Bush and recreated himself with his passionate film “The Inconvenient Truth” and won international fame and acclaim besides a Nobel.

The basic role of a director in today’s board is to secure his company against financial and non-financial risks. The word SECURE is an acronym that spells out those risks – Social risk, Economic risk, Climate change risk, Unforeseeable risks, Reputational risks and Ethical risks. In order to do that they have to be trained in the architecture of change - Re-envisoning , Re-evaluating and Re-engaging.

The challenge lies in turning directors into leaders capable of reenergizing the future rather than clinging to reiterating the truths of the past. Their basic role turns to becoming leaders of change. They have to remember that whatever made the organisation successful in the past wont in future. In order to survive, their companies have to be “different” and not better.

We all know that whatever gets rewarded gets done. For this our reward system has to change. They have to use and reward five Ds -difference, dissent, diversity, dialogue and disclosure. These are the real value enhancers, the competitive differentiators, in the economy of change and surprise.

We are living and working in a world of multitrack, materiality, multifunctional, multinational, multitechnology and multicultural space. Your customers, your suppliers and even your employees are no longer unquestioningly loyal. You need intense engagement and incredible communication skills to create buy in at

each stage. Leadership by telling and talking has to give way to leadership by acting and discussing, deliberating and debating and most of all living and becoming the change you seek in others. You have to turn your job into a cause, a passion that enthuses and excites and oozes out confidence that will make your staff do whatever you want them to do and whenever you want them to do. As Martin Luther King Jr said “If a man has not discovered some thing he would die .