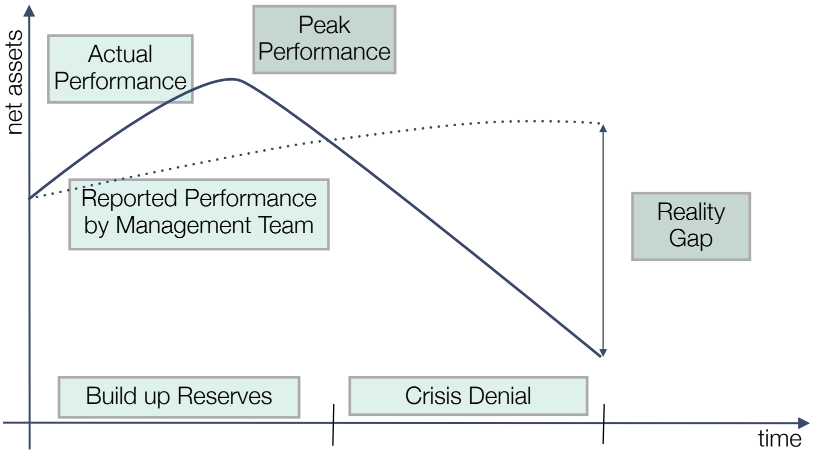
# **MOREGATE** Consulting

***Recent events led critics to suggest that Boards are too remote from operations. Directors lack domain knowledge and industry expertise. Combine this with the management team in denial, then a Reality Gap is opening up leading to suboptimal performance or outright disaster, financially or otherwise. More engagement from directors can lead to better corporate governance and a competitive advantage.***

### The misguided Board




### Results

- Change of board behaviour
- Conflicts of interest exposed - managers focus on performance improvement
- Better governance leads to better performance

## Competitive advantage through better corporate governance

Many businesses in distress have sound operations, a good product or service and a viable market position, but suffer from a bad balance sheet.

Questionable management of debtors and creditors and the introduction of new debt are an attempt to hide the real issues. Turnaround professionals call this the **"Reality Gap"**. Business performance has been suffering for a while, but management is in denial.

Over time the **reality gap opens up**, and the company slips gradually into crisis. Net debt increases and negative operational cash flows are tapered over.

### The Issue is at Board level

Why does the Board of Directors, the ultimate control vehicle, not realise that a reality gap is opening up?

In the UK, the board is a unitary board. Independent, non-executive directors and executive directors sit on the same board.

The issue with the unitary board approach is that a conflict of interest arises allowing the management team whose performance is to be evaluated to be in control of the **collection** and **presentation** of the data upon which that evaluation is to be made.

Rules and decisions are ultimately controlled by naked **preferences** of those in charge. Even if we presume that the management team would act logically and have valid reasons, ultimately, in choosing between alternatives, their preferences would be determinative, rather than a **balancing of interests** or the supremacy of reason through collegial debate and compromise.

### What needs to change?

A democratic structure rather than a military-style command and control structure where "benign dictators" are in control needs to prevail.

Under a **democratic** structure, decisions are reached through reason and compromise. The effectiveness requires a full airing of all information, open and frank discussions of competing views and reasons, and a culture that respects and yields to legitimate, opposing views. It is transparent, institutionalised and reliable.

### Better Governance

Better governance is a key reason for outperformance (as suggested by a McKinsey study, mckinseyquarterly.com, Feb 2005).

The democratic approach should lead to better governance. Better governance refers to the way directors and owners interact with the management team to create the greatest possible value.

It might, for example, involve the way the directors appoint managers, structure incentives or challenge on strategy.

The key is that directors take greater **ownership of strategic issues** at board level to expose the conflict of interest.

This may require a **"professional"** board with the independent directors having **relevant professional expertise** and increased time commitment, whilst **reducing the board size** to a maximum of seven members to improve effectiveness.

**Moregate** has helped boards to instill better governance. Key success factors are:

- Introduce a stronger performance culture
- Reporting against detailed KPI's and performance indicators
- Complement board papers with independent operational analysis
- Abandon sacred cows and give managers leeway to focus on improvements (short term and long term)
- Bring new managers in when necessary
- Directors to spend more time on their roles and focus on strategy and performance rather than compliance and risk avoidance

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