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TOWARDS THE BRIGHT PYRAMID

EES + G : Developing A Post-Covid Mindset For Corporate Governance

How Can We Escape The Current Dark Triangle?

At a post-Covid virus time of great world turbulence in health, economic, environmental and social relationships, I am optimistic that new governance opportunities are growing rapidly to better develop and control wisely our future organisations. Covid-19 has forced the intellectual and emotional turning point from which to reset public expectations of future organisational performance. This is despite the deep gloom and feelings of hopelessness held by so many people about the world in general, and in particular the current poor effectiveness and efficiency of our organisations: private, public and not-for-profit. The present situation shows an angry public's strongly negative bias towards the future quality of our organisational leadership. This is demonstrated publicly in their worries about the current and future quality of boards, directors and, specifically, Chief Executives. These worries can often be explained by the psychological phenomenon known as 'The Dark Triangle', where a blend of paranoia, narcissism, and psychotic behaviours combine toxically in our leaders create the psychic prisons in which many employees, managers and directors feel now trapped. But few of the public know what questions to ask to help break this triangle. Even fewer have heard of 'effective corporate governance' as a way of creating a better future for all.

Yet all is not lost. This global lack of public trust in effective governance is encouraging much critical questioning of the present and future basis of both national and corporate governance. Much social media criticism is focusing on how best to govern our future organisations. We are seeing small and energetic initiatives exploring these ideas and pressures and, most importantly, intending to distil and share internationally constructive actions and learning. The late

November 20020 global workshop across five continents via Zoom organised by the Caribbean Corporate Governance Association and their follow-on bi-monthly global workshops are a good example.

I am optimistic. But as we progress, I shall have in mind the words of the evolutionary biologist E O Wilson "we shall stumble into the twenty-first century having created a Star Wars-style civilisation, with Stone Age emotions, Medieval institutions, and God-like technology". For our own salvation we have to learn how to create better than this. I argue that effective corporate governance is a key to integrating the many new opportunities for all our organisations.

Current Issues

Current Corporate Governance Is a Ragbag of Untested Long Held Myths, Some Good Practice, and Much Comforting Legal Ignorance

One only has to watch social media, TV or read the newspapers to see so much international evidence of the mismatch of the economic, social and environmental impacts on society and the consequent under-performance of our organisations – private, public and not-for-profit. This is causing the public to demand of our directors, owners, legislators and regulators that they make radical changes to the future definition of 'effective corporate governance': 'something must be done'. But reliance on public outcry is not sufficient as the public is woefully ignorant of what 'effective corporate governance' means in practice. Sadly, and alarmingly, so are many directors, owners, legislators and regulators. In the consequent confusion we see often untested single, 'silver bullet' solutions offered every day. Most such proposals are random, unsystematic and biased in favour of the proposer. Many are likely to worsen the existing power balances by unbalancing them even further.

What can be done to rebalance effective corporate governance for the future? A lot. But only if we understand the history of how we got here. I argue that, at least in Common Law countries, we have grown since the late 1890s a patchwork of partial patches to immediate political, social, environmental, economic and governance issues without using a broader and long-term societal context. These patches have not created a rational, integrated system of effective corporate governance that combines the needs and performance metrics of directors, owners, legislators and regulators, under an agreed process of public oversight; something by which these parties can be held to public account.

This has been caused by the unquestioning and lazy acceptance of a number of self-perpetuating myths, and open secrets of which the public are unaware, and which few of those responsible are willing to declare publicly. For example:

- Nobody owns a company under Common Law. They are separate legal entities and personalities (legal fictions) created originally to help reduce personal liability of increasingly vulnerable and rich shareholders. But the ownership and control issue were never clearly resolved by the 1896 Salomon Judgement, of which the vast majority of directors, regulators or politicians have never heard. So, it has proved expedient for the current players to leave wide open the issue of who now controls a limited liability company? Hence the many failed court cases due to the inability to determine who is 'the controlling mind' that has the ultimate liability for a company and a board's actions. This allows the useful myth that shareholders 'own' a company to continue.
- Shareholders do not own a company, but they do own a right to have dividends when appropriate, to have a share in the residual company assets (should there be any) if things go wrong and to have rights to vote in AGMs and EGMs on who becomes directors, dividends, remuneration etc.
- Shareholders have become convenient and increasingly powerless kick-arounds but useful for the public to blame. Yet from the 1920s, building on the widely-accepted Berle and Means thinking from the US, they have been treated increasingly as irrelevant when compared to the growing power of the executives, especially the Chief Executive. Shareholders' only real power is seen in their ability just to buy and sell their shares.
- Similarly, since the 1920s, the supremacy of power in a business has leached away from the Board of Directors and towards the Chief Executive. The legal notion of 'the sovereignty of the board' has almost vaporised.
- Paradoxically, since the 1970s and Milton Friedman's much accepted focus on free markets, and the consequent emergence of the hazy concept

of ‘shareholder value’, the role of the Chief Executive was reinforced even further. The perverse thinking was that through the focus on them being rewarded ridiculously well, usually based on their raising the annual share price, (which often they alone could manipulate), the long-term interests of the shareholders would be protected. This is not proven. Markets are neither rational nor moral.

- Again, this CEO focus reduced the supremacy of the board who often felt as powerless as the shareholders. The power of others including stakeholders, regulators and legislators were then excluded as far as possible from the shareholder value game by a decades long battle to fight regulation of any sort. Yet it became convenient for all parties to blame increasingly the Board for all consequent business problems whilst denying them the legal clarity to understand their roles and the long-term purpose of a company. Everyone else could then posture and hold firm views on this, even if they knew little about the legal basis of governance.
- The Cadbury Report of 1992 was a breath of fresh air by introducing the term ‘corporate governance’ to the wider public, and, indeed to the majority of directors and politicians. But as he acknowledged before his death in 2015 it was a pity that it focused only on ‘The Financial Aspects of Corporate Governance’. It was sponsored by the London International Stock Exchange and the Institute of Chartered Accountants of England and Wales.
- This narrow focus on finance and Listed Companies became quickly accepted internationally. It was convenient, especially for many governments, for such a fashionable concept to be oven-ready. But this created two problems that have dogged the development of universally effective ‘corporate governance’ ever since. First, it has created an erroneous view that corporate governance is only for Listed companies. As Listed Companies form less than 5% of companies in most countries it meant that most private and family companies, state-owned enterprises and agencies, social benefit corporations and not-for-profits were assumed excluded. This left the environmental and social impacts of board decisions out of the definition of effective governance practice. They were left to retro-fit the existing Corporate Governance Code as best they could. This has led to much unnecessary distortion of what is currently called ‘good practice’.

- Second, the creation of the Corporate Governance Code from the 1992 Cadbury Report was copied so many times around the world, and so easily, that it came to be treated like Holy Writ. It was not and is not. It was a first attempt to codify both the law and good practice. Sadly, it became also a regulator and bureaucrat's dream. Copying it and imposing it on nationally registered organisations was the silver bullet that let legislators off the hook. They could then announce to the public that they had 'solved' corporate governance by applying the Code indiscriminately to all registered organisations in their country (regardless of appropriateness) and had then appointed regulators to enforce it.
- If there were subsequent issues the regulators could just add more clauses, sadly, often without checking the legal basics. As so many were ignorant of their own laws, they then over-rode them by expanding these creaky Codes. This was a muddled attempt to create law without due legislation. It has created confusing and sometimes contradictory secondary rules which neutralised or wrecked the intention of the original legislation. Yet no-one seemed to care as governance issues were mainly hidden from an indifferent or ignorant public. It was seen as a minor sport for geeks who should be left to their own devices. But as Adrian Cadbury pointed out in 2015 the entrepreneurial basis of effective corporate governance, and so the future of companies, was being destroyed by a fixation with the strict application of faulty Codes and this, taken to extremes over time, would destroy all forms of Wealth.

Covid-19, ESG and the Turning Point Towards the Bright Triangle

Covid-19 has given time for societies to refocus on their national governance and corporate inadequacies. It is becoming clearer to the public that companies cannot act as autonomous economic entities with unlimited life, unlimited size, unlimited licence, and, so, unlimited power. The public will no longer stand for this as we see currently with the growing attack on the 'tech giants'. In future they will need to negotiate a licence to operate only within a wider and integrated ecology, where not just economic impact but environmental impact and social impact must combine to deliver their long-term Purpose. In the third of his 2020 BBC Reith Lectures Mark Carney talks of the shift in public thinking from the market economy to the market society – the shift from Value to Values – and the search for new metrics to assess this. The search is on for integrated cost/benefit analyses, Quality of Life indicators etc.

The signs have been there for decades but especially since the Western Financial System Breakdown of 2008. A dramatic and key *mea culpa* was made by Alan Greenspan, ex- Chairman of the US Federal Bank in his book *The Map and the Territory* (2013) where he admits that their deep belief in the self-correcting nature of financial markets was shattered by the Crisis. 'The models did not work, despites some 250 PhDs working for me'. The driving factors not considered important by them during the meltdown were 'the nature and speed of market dynamics' in globally integrated financial systems, and, of great importance for the future, 'people and their unpredictable emotions'. The concept of Rational, Economic Man was dead. This has shattered macro-economics. In retirement he took a course in Anthropology to better understand human nature.

In August 2019, 181 CEOs of most of the largest US corporations wrote under the heading of the US Business Roundtable that they now committed 'to lead their companies for the benefit of all their stakeholders – employees, customers, suppliers, communities and their shareholders'. The Age of 'ESG' had arrived. The issues Environmental, Social and Governance impacts rose to the fore and boards now have to face this. Most still try to avoid it. These pressures to integrate business with wider society had been growing in public consciousness for some decades but had been ignored at corporate and legislative levels. They had assumed that for corporations 'CSR' was good enough. But Corporate Social Responsibility was a weak concept; easy to say, difficult to measure, and treated by most boards as a wimpish, feel-good factor unrelated to the fast-changing world reality.

'ESG' has risen as a harder-edged concept. It incorporates the demands of the Environmentalists, including, for example, corporate impacts on global warming, zero carbon and deforestation; with Social impacts on the communities within which a corporation operates in terms of employment, supply chains, community cohesion, and customer satisfaction; with Governance including clarity of the Purpose of the company; Duties of the Directors, Induction and Development to Competence of the Board, and the assessment of the performance of Directors and Executives. I note that many new scorecards and ratios are being developed for the future Environmental and Social impacts of a corporation. But so far we have few for assessing Corporate Governance performance, especially by the Investment community. This is a key international challenge.

The Bright Triangle

But even ESG is not enough. It lacks the entrepreneurial, economic element which is an essential element of good governance. Future boards will need to learn how to balance the Economic, Environmental and Social impacts of their decisions. So, imprinting 'EES + G' on their business brain is a wiser concept. It challenges boards of all sorts – private, public and not for profit – to refine their Purpose by learning to balance and rebalance in real-time the Economic, Social and Environmental consequences of their decisions on their communal eco-systems. They shall need to learn to negotiate their future 'licences to operate' in a society: their future life support mechanisms of their decisions.

This is a major mindset change from two-dimensional to three-dimensional thinking for the majority of boards. It is not new, but little known. Indeed, Section 171/ 172 of the UK's Companies Act 2006 (persuasive of company law across the 54 Commonwealth countries) concern both the Seven Duties of a Director and lists all three elements of EES as defining the purpose of a board of directors, and a company. Who knew? The trouble is that it is so rarely read, let alone used, as the foundation stone and basic induction tool for all new directors. I argue that Economic, Environmental, and Social Impacts (EES) are the three side of the new stable, triangular base on which boards can design their future to deliver their Purpose and balance the impacts of their decisions in each aspect. Such a mindset change is a major and often uncomfortable challenge for all of us as we move away from Dark Triangle thinking.

Towards the Bright Pyramid

However, you will have noticed that although I have mentioned 'EES' I seem to have dropped the 'G'' of Governance from the Bright Triangle. Not so but we have to move conceptually into three dimensions. This is where future directoral thinking needs to shift from two-dimensional to three-dimensional thinking. Apart from engineers and architects most professionals are not trained to think in three, or four, dimensions. Yet future boards shall need to integrate higher level Governance and Public Oversight thinking above even the levels of future EES decision taking. Remember that 'governance' from the ancient Greek means both seeing the way ahead (direction-giving) and ensuring prudent control of an organisation. Accepting 'EES + G' as defining effective future corporate governance creates a new and more effective long-term mindset for future boards. It creates a Bright Pyramid using 'EES' as the stable triangular, two-dimensional base; with 'G' as corporate governance forming the higher level, integrative balancing process to deliver the organisation's future Purpose, whilst still ensuring control in the present – a true Learning Board. And, crucially, with Public Oversight at the apex of the pyramid.

This cannot be claimed as a new concept, merely the integration of centuries' old concerns. We have struggled since 1776 with the issues of how we deliver Economic Wealth whilst balancing it with Moral Sentiment, Social Justice, Environmental respect, and effective Governance. That year saw the publication of three books that still shape the thinking of the modern world. Adam Smith's *The Wealth of Nations* (including Moral Sentiment), Jean Jacques Rousseau's *The Social Contract* on the rights and duties between the state and the individual, and the US *Declaration of Independence* leading to the US Constitution, dealing with the necessary balance in governing between the legislature, judiciary and the executive. They continue to challenge all of us about what we mean by 'effective governance', national or corporate.

I propose that we encourage the international development of small groups committed to critical thinking and implementation of EES + G to help restore public confidence in our organisations for the benefit of all; for corporate governance to play a significant role in creating the commonwealth.

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