Does Insider Knowledge Help or Hurt a Board?

Do boards consciously attract board members or executives who can bring information from other entities? Do they want them to provide the board with inside knowledge they can use to develop their own strategies? This practice raises at least three concerns: 1. Gathering intelligence to achieve desired outcomes. 2. The need to compete is stronger than the need to be trusted; 3. The need to know is stronger than the need to trust one’s own strategy. Three potential results of this practice are discussed. The first is the notion that the media can prolong the issue by focusing on it from multiple angles. The second relates to the fact that there can be a material result for the board. The final result discussed is the impact of the loss of trust.

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Introduction

Boards want the best board members on their teams and they want the best CEOs to manage their organizations. What does this mean for other entities? Do boards consciously attract board members or executives who can bring information from other entities to provide the board with valuable knowledge they can use to develop their own strategies?

Often, in order to obtain the best talent, it is essential to look at other entities to see who is governing and who is managing them. In the case of appointed boards, they can do that at the governance and management levels. They can scan their external environment and determine who sits on other boards and ask them to join them. In many cases, that is exactly how it is done. Elected boards are not able to engage in the same practice at the governance level unless they seek out specific individuals and ask them to run for office.

What does this practice of bringing board members from other boards or enticing the CEO to leave one entity to work with another board really mean? There are at least three concerns:

- Gathering intelligence to achieve desired outcomes
- The need to compete is stronger than the need to be trusted
- The need to know is stronger than the need to trust one’s own strategy
Three Concerns

_Gathering intelligence to achieve desired outcomes_

It is not unusual for boards to compare their results with others. Public sector boards such as school boards compare student results, access to technology, and the state of their schools to those in other boards. They use this knowledge to lobby for more and/or better resources and outcomes.

Health boards compare wait times, access to technology for vital testing and availability of specialist from one jurisdiction to another. Non-profit boards want to know about the strategies other entities used to raise money or garner support for their cause. Union boards want to know the strategies other union boards used to improve the benefits or salaries obtained via their collective agreements.

Businesses can use insider knowledge to improve products and services in areas such as technology, biotechnology, and telecommunications. According to Alex Lee, in his article _Corporate governance: boardrooms fret over corporate espionage and federal guidance regimes_,

The losses issue relates directly to shareholder value concerns as underrepresented or incorrectly reported lost profits and royalties negatively impact investor returns... Of equal concern to investors, shareholders and stakeholders is the problem of how companies actually deal with confirmed security breaches... Companies, by and large, are very reluctant to report any instances of theft for fear of damaging their reputations.

Competition is a given in all sectors. However, it can affect the degree to which any entity is respected and trusted.

To avoid negative consequences, boards expect board members and CEOs to follow their codes of ethics. But then again, how do boards deal with board members and CEOs who engage in unethical practices? One way is to adopt new board policies. Effective governance policies speak to the notion that board members and CEOs who
conduct unethical or illegal activities in the name of the corporation are dealt with by the board in a specific manner and sometimes involve the law.

**The need to compete is stronger than the need to be trusted**

When breaches of trust are publicized, relationships can be permanently damaged or destroyed. Boards and CEOs work diligently to remain out of the spotlight and make downplay the situation. They make comments such as

- The media has blown this out of portion
- We have been misrepresented
- It is not as it appears
- We have everything under control
- There is nothing to worry about
- They are trying to deflect attention away from themselves and we have done nothing.

Boards attempt to keep the situation as quiet as possible. Cases will be settled out of court whenever possible. Media or communication campaigns are started to boost positive public perception.
The need to know is stronger than the need to trust one’s own strategy

Sometimes this direction occurs by accident when someone asked, “Why reinvent the wheel? Just do what they are doing.” That seems like permission to use whatever tactic is necessary to speed up any processes by learning what others are doing correctly.

When this occurs, the CEO and the board lose sight of the need to evaluate risks at the management and governance levels. Decision making becomes flawed and fails to follow the process outlined in the Decision Making Model of Governance and shown in the figure below.

![Decision Making Model of Governance](image)

Judicial and regulatory bodies can stipulate that boards monitor risks and engage in ethical practices, however, the practice depends on the will of the board members and the CEO.
Potential Results for Boards Which Engage in Unethical Activities

There are many possible results. Three of those are discussed in this section. The first is the notion that the media can prolong the issue by focusing on it from multiple angles. The second relates to the fact that there can be a material result for the board. The final result discussed is the impact of the loss of trust.

Media Attention

Any breach of trust can quickly be brought to the public’s attention by the media, thus creating a barrage negative press. Many news shows include a portion inviting viewer feedback. Radio stations use such topics as fodder for their open-line shows. Television programs, such as Fifth Estate, use these concerns as topics for investigation. Social media, such as Facebook and Twitter, quickly expose any accusations of wrong doing. When this happens, the trust for that entity can wane very quickly.

New Material Costs

There can be many forms of material costs. The first cost occurs when boards are forced to pay damages to another entity. The second cost occurs when boards are required to revisit their conflict of interest policies. The third arises when certain board members have to be asked to leave the board and the board has to engage in the process of replacing them. The fourth occurs if it is necessary to release the CEO and compensate that person as per his contract. The final cost relates to the potential need to engage in a major public relations campaign to re-establish trust and open communication with all stakeholders.

All of these activities cost. There is a financial and an emotional cost. Sometimes it is easy to recover and other times the public, the media and regulatory bodies can keep the memory of past indiscretions alive and well.
Loss of Trust

When any illegal or unethical practice occurs, everything in the entity can be thrown for a loop. Focus is taken off the strategic directions set by the board. Stakeholders feel cheated and uncertain about their relationship with the entity. Some individuals become defensive and many will try to shift blame to others in order to avoid criticism. Other will become over-cautious and want strict monitoring and risk management systems put in place to ensure the same situation cannot occur again under their watch.

Partners can begin to avoid interaction with the entity. Potential board members can avoid either running for election on the board or accepting an appointment to such a board.

Boards that engage in fund-raising activities can find that individuals, groups and companies are less likely to continue to support them. They forget how much competition there is for financial input and now the reality is hitting where it hurts, in the financial statements.

Final Comment

Using any person to gain insider knowledge can be a costly mistake for many boards. Most people do not forget indiscretions and many are reluctant to forgive. They remind the entity and others long after the entity has paid its penalties. These costly penalties may have been financial, loss of good will, or failure to garner future support. Whatever they are one has always to question, "Was it worth it? Did the costs outweigh the benefits gained by the organization?"