

Arming Directors with Skills for Effective Management of Board Disputes

Boards will inevitably confront disputes involving corporate governance issues that they often are ill-equipped to resolve. Yet few directors see the need to learn about alternative dispute resolution (ADR) approaches—until they end up with a paralyzed and ineffective board or costly, protracted, and destructive litigation. For the enterprising corporate governance capacity-building organization, there is a market for helping directors acquire necessary skills and knowledge to manage intense deliberations and conflict.



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Background

Disputes over corporate governance issues—the board’s powers and actions or its failure or refusal to act—are commonplace as boards forge decisions from the viewpoints of many directors. How a company is owned, its business model, the type of investors and stakeholders involved, and directors’ personalities and demographics—all give rise to differences of opinion.

It is not uncommon for disputes to emerge between the chairman and the chief executive officer over business strategies and the division of power. In family-owned companies, relatives may wrangle over leadership succession. Related-party transactions can lead to contention when their only purpose seems to be to provide outsized profits to a board director’s business partner. A chairman may be entangled in a fierce battle over the release of financial results. Or a state-owned shareholder may demand more board seats to gain controlling power over other investors.

Typically, common patterns of disputes are evident in like companies operating in similar industries and economies. (See Box 1.)

“We work with about 30 family-owned companies and see how issues of jealousy—why one son was promoted over another to become CEO—and emotional conflicts between parents and/or their children can endanger a company’s future,” says Leonardo Wengrover, a civil engineer who is CEO of W Advisors, a multi-family office company.

Despite rules and procedures to promote orderly and productive discussion, disputes may intensify and become irreconcilable. As a consequence, the board becomes paralyzed, jeopardizing the company’s survival. Publicly traded companies may see their shares plummet as investors’ confidence erodes. Family owners may panic and sell quickly at a low price, destroying the value of the company their family built over several generations. And,

ABOUT THE FORUM

IFC Global Corporate Governance Forum supports corporate governance reforms in emerging markets and developing countries. The Forum develops advanced knowledge and training products promoting good practices in corporate governance and facilitates capacity building of director training organizations engaged in implementing corporate governance reforms.

The Forum partners widely with international, regional and local institutions, and draws on the guidance of its global network of private sector advisors and academic research network.

The Forum is part of the IFC Corporate Governance Group, located in the Environment, Social and Governance Department. It is a donor-supported facility, co-founded in 1999 by the World Bank and the Organisation for Economic Co-operation and Development (OECD).

Cover Photo: Private Sector Advisory Group members Philip Koh and Leonardo Viegas discuss uses of consensus-based dispute resolution. Photo by Gail von Bergen Ryan.

competitors will likely exploit these situations to expand market share, including by a hostile takeover.

Few boards have procedures for such disputes—or members with the skills and experience to handle them. Typically, the costly, lengthy, and destructive legal battles that result may not resolve the issues, and the tensions that arise may continue to dominate board deliberations and decisions long after the conflict first erupted. (See Box 2, for example.)

BOX 1

Sources of Common Disputes in Family-Owned or Family-Run Companies

Altruism: Family well-being is promoted above business interests.

Opportunism: Growth in profits creates a temptation to siphon funds for personal use, to the company's disadvantage.

Self-Control: Total control by a family often means there are no external control mechanisms.

Moral Hazard: Family members may shirk work responsibilities, knowing they are protected by their family ties.

Adverse Selection: Hiring relatives first may result in incompetent leadership.

Goal Dissonance: Unrelated managers running the company for family owners may have goals that are irreconcilable with those of the family owners.

Bounded Rationality: Close ties of family may limit the capacity to gather and process information.

Source: Based on Manoj Joshi and M. Akbar. "Endogenous Agency Problems, Their Impact and Mitigation in Privately-Held Family Firms for Sustaining Growth." *Amity Business Journal* 1, no. 2 (August 2012). Available at <http://ssrn.com/abstract=2061948> or <http://dx.doi.org/10.2139/ssrn.2061948>.

BOX 2

Family Struggles Have Real Costs

A tabloid-worthy family feud erupted in 2008 at Hong Kong's biggest property developer, Sun Hung Kai Properties Ltd. (SHKP), owned by one of the richest families in Hong Kong.

The drama was triggered when the company's chairman and CEO reportedly wanted to bring his lover onto the SHKP board. That prompted his two younger brothers to stage a boardroom coup, ousting him and replacing him with their 79-year-old mother. The raft of subsequent lawsuits included a defamation suit that the ousted CEO filed against his brothers, who had written letters accusing him of suffering from manic depression and of being a "liar."

The consequences of this family struggle were devastating for shareholders.

"What happens when family loyalty turns to family feud? In the case of SHKP, the company's market value dropped \$4.6 billion over a seven-day period," reporters wrote in a story published in Asia Times Online at the time. (Asia Times Online: http://www.atimes.com/atimes/China_Business/JE28Cb01.html)

Fearing the peril of reactions within their own company, boards increasingly recognize the need for establishing and using ADR procedures instead of the courts. These procedures include the use of an ombudsman, or third-party peacemaker, a mediator, or an arbitrator. Unlike litigation, which inherently intensifies antagonism among disputants, ADR brings out shared goals and promotes common interests. It encourages cooperation and emphasizes inclusive decision making.

Bringing in a neutral third party, a so-called peacemaker, a mediator, or an arbitration panel often results in expeditious decisions that foster a sense of ownership and build collaboration toward a win-win outcome—in contrast to court battles, which tend to result in a winner and a loser and leave long-lasting divisions within a board.

Mediation is also considerably less expensive than litigation. According to a report compiled for the Policy Department of the European Parliament, while the average cost to litigate in the European Union is €10,449, the average cost to mediate (inclusive of the cost of the mediator and legal representation during mediation) is €2,497—an average savings of €7,952 per dispute.

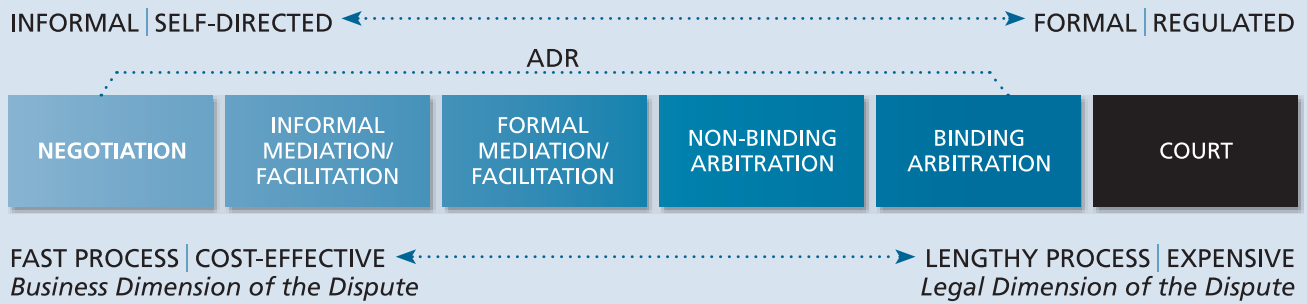
ADR approaches can achieve solutions more quickly than the courts by, first, narrowing the issues to the core ones; second, building trust between both sides while lessening the emotional and political tensions; third, facilitating discussion that yields proposals for solutions and establishes ownership of the outcome among all disputants; fourth, achieving compromise that all sides feel they helped shape and can commit to; and, fifth, monitoring the process to ensure compliance. (See also Table 1 and Figure 1.)



A dispute among the shareholders of the hypermarket "Lenta" in Russia, in which two people considered themselves the legitimate general managers, led to a violent attempt to solve the problem. One side stormed the headquarters, using tear gas and smoke bombs. Photo by Alexander Petrosian.

FIGURE 1

Comparing Dispute-Resolution Mechanisms



SOURCE: Adapted from Lukasz Rozdeiczer and Alejandro Alvarez. *Alternative Dispute Resolution Manual: Implementing Commercial Mediation*, Washington, D.C.: IFC, 2006. Available at: <http://advisoryservices.ifc.org/docspubs/docpub.aspx?id=621>.

To help directors understand ADR and build leadership skills essential for constructive board discussions, the IFC Global Corporate Governance Forum developed the toolkit *Resolving Corporate Governance Disputes*. The toolkit builds on adult-learning techniques and provides examples that illustrate how to prevent and effectively manage corporate governance disputes. It also includes practical suggestions and resources for institutions and companies—to help them implement good corporate governance practices as well as find ways to manage and prevent disputes. It provides the tools—including case studies, sample documents, and such activities as role-plays—for highly interactive training and awareness-building sessions.

TABLE 1

Differences Between Arbitration, Mediation, and Litigation

Arbitration	Mediation	Litigation
Voluntary	Voluntary	Involuntary
Binding, subject to challenge in court	If agreement, enforceable as contract	Binding, subject to appeal
Arbitrator selected by the parties, may or may not have subject expertise	Facilitator selected by parties, may have subject expertise, may be facilitative, evaluative, or a blend	Imposed, decision maker has subject expertise
Formal	Informal	Formal, rigid rules
Opportunity for each party to present proofs and arguments; Focused on past events	Unbounded presentation of evidence, arguments, and interests; Focused on the future	Opportunity for each party to present proofs and arguments; Focused on past events
Outcome: imposed decision, supported by reasoned opinion	Outcome: mutually acceptable agreement or consent decree	Outcome: imposed decision, supported by reasoned opinion
Private	Private	Public

The toolkit serves multiple purposes. For instance, ADR programs can use it to inform themselves on issues specific to corporate governance. This enables them to better tailor their services to the needs of boards of directors. Boards can learn how to choose and engage with various ADR services. The toolkit can be used to train directors on various ADR skills to improve their effectiveness on the board. (See also Figure 2.)

The skills involved in ADR processes can help directors in their everyday work, even with the most routine matters. These tasks may involve managing relationships within the board, fostering

cooperation between the board and senior management, and gaining stakeholders' trust. Effective communication, a critical ADR skill, helps directors perform better in such functions as building consensus, conducting oversight, and setting strategic direction.

For director-training organizations, ADR programs offer a potentially good source of income, if the organizations can demonstrate to directors the immediate and long-term value of acquiring ADR skills.

Corporate Governance Dispute Resolution Toolkit Use and Product Offerings

Client Assessments and Guidance

- CG Assessments
- Firm-Level Advisory
- Nominee Director Guidance

Institution and Capacity Building

- Training Directors/ToT
- Training Mediators/ToT
- Membership Services/Consultancies

Best Practice and Regulations

- Code Development
- Listing Rules and Regulations
- Regulated CG DR

Advocacy and Awareness

- Functions and Events
- Media Training



How to Introduce Dispute-Resolution Skills to Board Directors: Lessons Learned and Good Practices

IFC, in collaboration with the Centre for Effective Dispute Resolution (CEDR, based in London, United Kingdom) supports the Corporate Governance Dispute Resolution Practice Group, which includes director training organizations, ADR institutions, individual practitioners, and IFC staff. The following lessons learned are based on experiences of the Brazilian Institute of Corporate Governance (IBGC), a pioneer institution in introducing dispute-resolution skills into director-training programs, and other practice group members.

PROGRAM DESIGN AND MARKETING

Don't sell "ADR"!

It is a challenge to convince board directors either to seek out third-party help or to train for corporate governance dispute resolution. Few directors see the immediate need if their boards are not involved in conflicts or disputes. Others find it difficult to recognize the merits of using court alternatives, citing their unfamiliarity with such approaches, the lack of precedents, and the uncertainties involved. Directors often resist resorting to outside help until the conflict has become unmanageable.

The solution is to sell not ADR per se, but rather the practical skills that will help directors manage difficult conversations and conflicts on the board and act as effective mediators, when appropriate. A training organization can start by including an abbreviated ADR training module in its general corporate governance training programs. That introduction can be used to attract interest in more extensive ADR training.

Start by putting your "toe in the water" with a small training module.

For the last five years, IBGC had included a three-hour module on dispute resolution within its 64-hour director-training program—to "whet the appetite" for further training in ADR, according to



James South, a CEDR director, and Chris Razook, IFC program manager, during a Corporate Governance Dispute Resolution Practice Group meeting in London, April 2012. Photo by Gail von Bergen Ryan.

Leonardo Viegas, IBGC deputy chairman, lecturer, and member of the Private Sector Advisory Group. "This module was based on the early developments of the Forum's ADR toolkit and allowed us to introduce the concepts within the context of corporate governance," he explains. "We could see what interests the training participants and use their feedback to guide training focused exclusively on ADR when the toolkit was completed." This approach helped the institute refine the curriculum, build trainers' skills, and sharpen interactive exercises.

IBGC discovered that, once directors attend these short dispute-resolution sessions, it becomes an eye-opening experience. They find trainings too short and are eager to acquire the skills that would help them manage many types of difficult conversations during board deliberations. This "toe in the water" allowed IBGC to follow up with a dedicated, full-day ADR program.

Emphasize positive outcomes from training. Frame them as the key to success in the boardroom.

Emphasizing the positive aspects of ADR training is essential to effective marketing—a point stressed by participants at an April 2012 workshop in London jointly sponsored by the CEDR and the Forum. Just the words themselves—alternative dispute resolution—“evoke unpleasantness,” one participant noted.

“Management of corporate governance disputes needs to be embedded into standard corporate governance training for board directors.”

Leonardo Viegas
Brazilian Institute of Corporate Governance

Directors typically do not see the merits. “We don’t have disputes, so we don’t need this training,” said another workshop participant. Several suggested that people are motivated best when they are told what could happen—the potential looming costs—if they don’t do anything, rather than being told “they should do something.”

After lengthy discussions, IBGC decided to name its extensive, full-day program “Strategies in Mediation-Building Consensus in the Boardroom.” This, IBGC felt, conveyed a more positive emphasis than the terms “conflict management” or “dispute resolution.”

LOGISTICS

Maximize the benefits of interactive training by limiting sessions to 20 participants.

Communicating effectively is a core skill in ADR. Training modules should allow sufficient time for all participants to share in discussions and to practice skills development in exercises. To accomplish this level of participation, trainers advise limiting enrollment to 20 people.

IBGC ran its first full ADR program in Porto Alegre, in the state of Rio Grande do Sul, a region where there are many highly successful small and medium nonlisted family businesses, typically started by Italian and German immigrants more than 100 years ago. IBGC charged a fee, attracting 14 participants who had graduated from



Role-play exercise during IFC-facilitated ADR pilot for IBGC, May 2010.

IBGC director-training programs and, therefore, were familiar with corporate governance concepts and practices.

CURRICULUM/TRAINING

Provide readings and other materials in advance, so participants can prepare, particularly for the case studies and role plays.

Role play, where participants can apply their ADR skills, is essential to a successful training. “We found that it is important to plan the interactive activities a week before training,” says Viegas. “This makes the activities more successful, because the participants are comfortable with the roles they would act in and they have had some time to think about the points they want to convey.” But interactive sessions can easily get out of hand, so several IFC partners advise ironing out procedural and other issues to ensure a seamless performance.

Find relevant case studies that participants immediately see as providing needed insights.

“Success stories that speak to the concerns of the chairman, CEO, board directors, and senior management turn the skeptics into ADR advocates,” says Barney Jordaan, head of the Africa Centre for Dispute Settlement (ACDS) at University of Stellenbosch Business School. Marketing of ADR training and the curriculum must use case studies that demonstrate successes as well as the consequences of failures.

It is also important for the case studies to closely reflect the issues most relevant to a particular market. For example, in many emerging markets, the issue of related-party transactions stands out as one of the most common causes for corporate governance disputes. (See Figure 3.) Family-owned or family-controlled companies dominate many economies, and they have unique issues and decision-making processes that differ from those of public companies or state-owned enterprises. The disputes typically involve one or more of the following issues: succession, related-party transactions, family members in management, private use of company assets, and priority setting (whether to distribute dividends or reinvest earnings).

Emphasize adult-learning techniques throughout; avoid lectures.

Discussions involving participants are more effective than lectures. Such discussions bring home the point that each dispute requires its own combination of attributes and skills. Three skills typically emphasized in training are listening, communicating, and implementing. In developing these skills, the instructors encourage participants to draw from their personal experiences.

The IBGC’s program involved five elements: a conceptual introduction to ADR and corporate governance; arbitration essentials; a case study in the “fishbowl” training format (participants assume the roles that the others observe, take notes on what they see, and then analyze their observations after the scenario is played out); building negotiation skills through active learning techniques, including group exercises; and an experience-sharing panel with four trainers.

Provide and manage opportunities for participants to share experiences and ask questions.

Participants typically have extensive experience from their senior roles. They are accustomed to exercising leadership through decision making, consensus building, and articulating their views. Training sessions are stronger when participants share their experiences with peers who may be confronting similar situations.

Allow participants to offer answers themselves. This enhances their motivation.

One highly successful session for IBGC’s program was a case study its trainers developed based on a real example. It centered on one family member, who felt her involvement in the family business was not at an acceptable level, given her academic background and

of body language and what that communicates. You need to get into the other persons’ shoes, too, to understand their points and their reasoning. This helps you to see how some issues are not part of the business conflicts but tied to personal emotions and family history. Often, families don’t know how to talk to one another.”

Other skills are important, too. Many trainers believe a good corporate governance dispute-resolution program should build the following skills: active listening, clear and concise communication, tact and discretion, open questioning, constructive dissent, respect for differences, consensus building, and emotional intelligence.

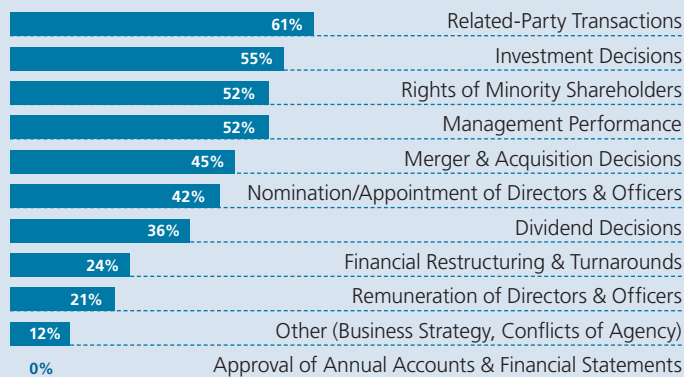
Finally, training pilots conducted by IFC and CEDR in various regions show that participants must have a firm grasp of corporate governance before tackling ADR skills development.

End with “lessons” — action items — the participants can apply in their roles as board directors or advisors.

By focusing on lessons, participants can distill the most relevant information out of what they’ve learned — lessons that will guide them. Defining lessons helps participants organize the information within their existing body of knowledge. Working with that information to define action items helps them take ownership of reform efforts in their organizations.

FIGURE 3

Common Corporate Governance Disputes in Brazil



Source: Brazilian Institute of Corporate Governance (IBGC). Data collected from participants in the IBGC directors program.

her professional ambitions. Her husband, an investment banker, suggested that she sell her shares to the company’s competitor. Doing so would net a high price, giving her the capital to fund her own initiative.

“This touched on many of the issues that family companies experience,” says Wengrover. “And the case had many questions that don’t have a straight ‘yes’ or ‘no’ answer — that go to the heart of what the values are that matter for family owners and the source of the business’s success.”

Allocate sufficient time for communications skills development.

“The training reinforced the idea about the importance of talking about the problems — having the difficult conversations using good communications skills,” says Wengrover. “This means being aware

EVALUATION

Provide evaluation forms that ask participants for specific comments — good and bad — rather than general impressions.

Evaluation results guide decisions concerning various components of training, such as instructional design, delivery, and results. Evaluation responses foster accountability and help determine whether to continue, modify, or eliminate the training components. This feedback provides invaluable counsel in determining priorities and allocating resources for future training.

Evaluation forms should ask questions about every aspect of the program, from inputs (the resources used to create the program) to outcomes (the impact of the training on each participant and his or her organization). Participants should be encouraged to provide extensive comments rather than simply rating the training components on a “1–5” scale.



Visit www.gcgf.org/disputes for the following resources.



Resolving Corporate Governance Disputes Toolkit.

The toolkit provides practical guidance on how consensus-based alternatives to adjudication can help prevent, resolve, and reduce the negative impact of CG disputes and consequently contribute to

improving CG practices, strengthening investor confidence, and supporting business continuity.

When Grandpa is also the CEO—Resolving Differences in Family-Owned Businesses. Barney Jordaan argues that the best cure for conflicts in family businesses is prevention—through establishing basic family governance structures and, failing that, dispute-resolution processes.

Mediating Corporate Governance Conflicts and Disputes.

This paper explores how consensus-based alternatives to adjudication—especially mediation—can help resolve corporate disputes.