

IFC Corporate
Governance
Knowledge
Publication

Boardroom Disputes

How to Manage the Good, Weather the Bad, and Prevent the Ugly

Practical Guide for Directors



© Copyright 2014. All rights reserved.

International Finance Corporation

2121 Pennsylvania Avenue, NW,
Washington, DC 20433

Centre for Effective Dispute resolution

International Dispute Resolution Centre
70 Fleet Street
London EC4Y 1EU

The findings, interpretations, and conclusions expressed in this publication should not be attributed in any manner to the International Finance Corporation (IFC) and/or to the Centre for Effective Dispute resolution (CEDR) and their affiliated organizations, or to members of their boards of directors or the countries they represent. IFC and CEDR do not guarantee the accuracy of the data included in this publication and accept no responsibility for any consequence of their use.

The material in this work is protected by copyright. IFC and CEDR encourage dissemination of this publication and hereby grant permission to users of this work to copy portions for their personal, noncommercial use, without any right to resell, redistribute, or create derivative works there from. Any other copying or use of this work requires the express written permission of the International Finance Corporation.

For permission to photocopy or reprint, please send a request with complete information to:

International Finance Corporation
c/o the World Bank Permissions Desk
Office of the Publisher
1818 H Street, NW
Washington, DC, 20433

All queries on rights and licenses including subsidiary rights should be addressed to:

International Finance Corporation
c/o Office of the Publisher
World Bank
1818 H Street, NW
Washington DC, 20433
Or, fax (202) 522-2422



BOARDROOM DISPUTES

How to Manage the Good, Weather the Bad, and Prevent the Ugly

Contents

- INTRODUCTION 3
- OVERVIEW 4
 - Disputes Can Put the Company at Risk 4
 - Defining Corporate Governance Disputes 6
 - CGDR Self-Assessment and Progression Matrix 6
- 1. CLARIFY THE ROLES OF MANAGEMENT AND THE BOARD 8
- 2. ESTABLISH ORDERLY BOARD PROCESSES 10
- 3. ENSURE THE PROPER FLOW OF INFORMATION 14
- 4. ENCOURAGE A BOARD CULTURE THAT ALLOWS FOR EFFECTIVE DISCUSSIONS, DEBATES, AND DELIBERATIONS 16
- 5. STEP OUT OF THE BOARDROOM TO GAIN NEW PERSPECTIVES 19
 - Board Assessments 20
 - Board Retreats 20
- 6. APPLY DISPUTE RESOLUTION SKILLS AND TECHNIQUES 22
 - Communicating Effectively 22
 - Respecting Cultural Sensitivities 26
 - Building Consensus 26
 - Managing Emotions 27
 - Disagreeing Constructively 27
- 7. INCORPORATE ALTERNATIVE DISPUTE RESOLUTION INTO THE COMPANY’S CULTURE AND PRACTICES 30
 - Benefits of ADR for Resolving Corporate Governance Disputes 30
 - Who Should Manage the Dispute Resolution Process? 33
 - Helpful Documents 34

Boxes

0.1: Excerpts from CEDR-IFC Survey Responses 5

1.1: Board Responsibilities 9

2.1: Robert’s Rules—And Breaking Them 11

3.1: Briefing Papers 15

4.1: Factors to Consider for Director Nominations 17

4.2: Role of the Chair 18

6.1: Assessing the Board’s Interpersonal Skills 28

6.2: Techniques for Defusing Disputes in Boardrooms 29

Figures

5.1: Board Retreats 21

6.1: Important Interpersonal Skills 24

7.1: Alternative Dispute Resolution 31

Tables

0.1: CGDR Self-Assessment and Progression Matrix 7

6.1: Conflict Resolution Skills Ladder 23

7.1: Comparing Mediation, Arbitration, and Litigation 32

7.2: Peacemaker Skills Mix 33

INTRODUCTION

A dynamic board seeks to stimulate the flow of ideas, identify key issues, consider alternatives, and make informed decisions. And for that you need deliberation and debate. But these positive processes can sometimes turn into boardroom disagreements that must be dealt with properly and promptly; otherwise, they can devolve into acrimonious disputes that undermine the board's effectiveness and the company's performance.

This paper describes key steps that boards can take to mitigate the impact of disputes—and, even better, to minimize the risk of disputes arising in the first place. It is intended as companion and post-training material for a course called “Managing Disputes and Difficult Conversations on the Board.” This highly interactive course for board directors was created by the IFC Corporate Governance Group in partnership with the Center for Effective Dispute Resolution (CEDR). It is designed to help directors understand board conflict and conflict styles, and it covers difficult scenarios that directors often encounter. The course offers guidance and practical tips for how to have a difficult conversation; for handling avoidance, high emotions, and status issues; and for breaking through deadlock—and how to apply these skills specifically in a board context.

This publication also can be used as stand-alone guidance for boards. While the training itself focuses heavily on individual development of interpersonal skills relevant in the board context, this publication also deals with the board as a collective body that needs to cultivate its ability to manage disputes effectively—starting by establishing good corporate governance policies and practices.

The advice is geared toward a single-tier board, but the principles described in this publication can be easily adapted to different board structures.

The paper builds on IFC's “Resolving Corporate Governance Disputes”¹ and its internal IFC “Board Toolkit.” In addition to numerous people who contributed to those publications, IFC and CEDR would like to thank the following peer reviewers and contributors: Amira El Saeed Agag (IFC), Phil Armstrong (IFC), Philip TN Koh (Mah-Kamariyah & Philip Koh), Mary Jo Larson (Independent Consultant), Maggie Rego (IFC), Alan Rudnick (Masters-Rudnick & Associates, LLC), and Olli V. Virtanen (Virtanen Associates Oy).

The IFC Corporate Governance Dispute Resolution program² aims to equip board directors with knowledge, skills, and tools to manage and resolve corporate governance disputes and difficult conversations on the board. Its dual purpose is to 1) reduce the negative impact of disputes on the company's reputation and performance and 2) improve the quality and effectiveness of board deliberations. The program brings together corporate governance and alternative dispute resolution (ADR) specialists to develop knowledge and training products and guide their implementation.

CEDR is a not-for-profit organization³ that campaigns for better resolution of disputes and management of conflicts. Its innovative initiatives promote awareness of the need for more effective leadership in collaboration and dialogue and how to achieve it. CEDR is Europe's largest independent ADR service and leading international negotiation and conflict management trainer. It also consults globally on civil justice reform and helps businesses develop conflict management systems.

1 Global Corporate Governance Forum, *Toolkit 4: Resolving Corporate Governance Disputes* (Washington, D.C.: IFC, 2011). http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/Global+Corporate+Governance+Forum/Resolving+Corporate+Governance+Disputes/.

2 See www.ifc.org/corporategovernance.

3 See www.cedr.com.

OVERVIEW

Disagreements in the boardroom are unavoidable – especially when the board has independent-minded, skilled, and outspoken directors, each contributing expertise and talent that is relevant for the future of the company. A good board includes a diverse group of people, considers and debates a variety of issues, and aims for consensus decisions; no one person's views prevail 100 percent of the time. A board that never argues or disagrees is most likely inactive, passive, or inattentive – in other words, an ineffective board that is neither fulfilling its oversight function nor carrying out its duty of care. Yet if boardroom disagreements are not dealt with properly, they can escalate quickly into public matters that can have severe, long-term consequences for the company and its key stakeholders.

Disputes Can Put the Company at Risk

In 2013, CEDR and the IFC Corporate Governance Group conducted a global survey of 191 directors and board members to learn about their experiences with and attitudes toward boardroom disputes.⁴ Our results show the significant effects that boardroom disputes can have on an organization, and the challenges that individual members of those boards find in attempting to resolve them. (See **Box 0.1**.) The following are some of the results of the survey:

- A sizeable portion (29.6 percent) of respondents have experienced a boardroom dispute affecting the survival of an organization.
- 42.8 percent of respondents report that conflict reduced the level of trust among board members.
- The most common subject matter of disputes is “financial, structural, or procedural workings of the organization,” closely followed by the “personal behavior and attitudes of directors.”
- Disputes are most commonly resolved through internal negotiation (61.2 percent) or internal mediation (25.2 percent).
- A significant proportion of respondents (67.2 percent) report that they have encountered unresolved issues; 15.6 percent report that conflicts are not resolved “frequently,” and another 11.0 percent report that the issues are resolved “frequently” by “avoiding the conflict and letting it pass.”
- Respondents say that the most frequent complicating factor in resolving disputes are “issues regarding handling the emotions of those involved,” and this was the second-most difficult factor to deal with after issues over “competing factions on the board.”
- Respondents are extremely eager for training in dealing with personal factors, with 74.8 percent describing training in the “ability to deal with different personalities” as very useful.
- A gender difference emerged regarding which skills respondents desired: women are far more interested in receiving training in negotiation skills, while men are more keen to receive training in how to deal with different personalities.

⁴ IFC Corporate Governance Knowledge Publication, *Conflicts in the Boardroom Survey—Results and Analysis* (Washington, D.C.: IFC and CEDR, 2014). http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/corporate+governance/publications/guidelines_reviews+and+case+studies/conflicts+in+the+boardroom+-+survey+2013.

Box 0.1: Excerpts from CEDR-IFC Survey Responses

“The CEO’s abrasive style with zero appetite for ‘changes’ has pushed the company to a stage wherein the company is under attack from the stakeholders, including the creditors.”

“Factionalism [exists] on the board, and an unwillingness on the part of the chair to demand that members pull together—instead [there is] much manipulation and backroom dealing.”

“Alpha members of the board [are] not listening to others or not ‘hearing’ them, especially women (or those perceived to be of no importance); [there is] lack of empathy or ability to appreciate motives of others.”

“In my experience the *avoidance of the dispute* is the biggest problem, especially in a company with a dominant shareholder and two minority shareholders, where the minority shareholders are suffering most from results of avoidance but are hardly part of the conflict management, as the conflict is played outside the board/board meetings.”

Defining Corporate Governance Disputes

Corporate governance disputes involve the board's powers and actions or its failure or refusal to act. These conflicts may arise between the board and its shareholders or between directors and executive management. They may also involve issues among the directors themselves or between the board and other stakeholders.

The list of possible sources of conflict is endless and includes issues related to the business itself (*what* is being done—strategic priorities, related-party transactions, company control), board processes (*how* things are done—appointment of new directors, defining board agenda, succession planning), and personalities (*who* is doing things—behaviors and attitudes of directors). Regardless of its source or nature, a governance dispute implicates the board in one way or another as a party or as an active participant, and resolving the conflict requires the directors' concurrence.

In further defining corporate governance disputes, we should distinguish them from other types of disputes that may involve a company. For example, a dispute over a contract, a labor claim, or a commercial matter involves the company as an entity but does not pertain to its governance. Such disputes are typically part of doing business, and it is generally up to management to resolve them.

It is important to note that this paper does not deal with any specific type of conflict, such as a shareholder dispute or a clash over related-party transactions; for help with specific situations, you should seek independent professional advice. Instead, we focus on policies, procedures, and directors' skills that help resolve disagreements in a constructive way, prevent some conflicts altogether by removing common "irritants," and create the circumstances for a productive board environment.

CGDR Self-Assessment and Progression Matrix

To keep disputes from being destructive, the first and most important responsibility of the board is to apply good corporate governance practices, including initiating steps to minimize the risk of having disputes arise in the first place. The second responsibility is to see to it that individual board members develop the skills needed to better manage disputes and heated negotiations. To achieve these goals, a board should consider adopting the following interlinked steps, tailoring them to the board's particular circumstances:

1. **Clarify the roles of management and the board.**
2. **Establish orderly board processes.**
3. **Ensure the proper flow of information.**
4. **Encourage a board culture that allows for effective discussions, debates, and deliberations.**
5. **Step out of the boardroom to gain new perspectives.**
6. **Apply dispute resolution skills and techniques.**
7. **Incorporate ADR into the company's culture and practices.**

Table 0.1 presents the Corporate Governance Dispute Resolution Self-Assessment and Progression Matrix, which summarizes specific elements of those key steps. It is formatted to help boards conduct a basic self-evaluation of their readiness to prevent, manage, and mitigate the impact of corporate governance disputes. It shows boards where they might be in the matrix and what they need to do to build a roadmap to improve.

These seven steps form the structure of this paper. Each section expands on one step, exploring it in greater depth.

Table 0.1: CGDR Self-Assessment and Progression Matrix

SEVEN DIMENSIONS IN PREVENTING AND MANAGING BOARDROOM DISPUTES	LEVEL 1	LEVEL 2	LEVEL 3
	No	Somewhat/ Sometimes	Internalized practice
1. Clarify the Role of Management versus the Board			
There is clear and detailed delineation of board and management authorities/roles/responsibilities	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Each committee has a charter clearly delineating its functions	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The CEO has clear limits on expenditures not requiring board approval	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
2. Establish Orderly Board Processes			
There is a yearly calendar for board and committee meetings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Board meetings protocol establishes procedural rules and behavior expectations, including how each director can add matters to the agenda	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Meeting agendas ensure an appropriate amount of time for each decision item to be discussed	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Meetings include “executive sessions” (sessions without management or CEO)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Board minutes clearly present issues discussed, decisions made, and basis for decisions	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
3. Ensure Proper Flow of Information			
Key business performance indicators are established and regularly reported to the board	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Board is regularly updated on the implementation of previous decisions	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Board briefing papers are focused and allow for informed board decisions	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Board briefing papers are distributed no less than a week before the meetings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
4. Encourage a Board Culture that Allows for Effective Discussions, Debates, and Deliberations			
Different points of view and debate are welcomed during board meetings	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Board deliberations are collegial and civil	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Consensus is the preferred way to make decisions	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Chair encourages frank and open discussion that each director can participate in	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
5. Step out of the Boardroom to Gain New Perspectives			
Regular informal settings give directors the opportunity to better know each other	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The chair or lead director meets at least once a year with all the other board members individually to know their points of view of the company and the board	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The CEO meets at least once a year with each director to hear his or her views about the company, management, and the CEO’s performance	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Board undergoes regular assessments/evaluations	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Board holds an annual retreat outside company premises	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
6. Apply Dispute Resolution Skills and Techniques			
Chair is adept at building consensus	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Directors have good interpersonal communication skills	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
7. Incorporate ADR into the Company’s Culture and Practices			
Board’s bylaws or governance principles or guidelines include a provision on how disputes will be resolved	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
One or more directors on the board have mediation training and/or are trusted and able to play an internal mediation role, when needed	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The board has a code of ethics that directors sign during induction	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>




CLARIFY THE ROLES OF MANAGEMENT AND THE BOARD

Clarifying the roles of the board and management is crucial to preventing disputes. Failure to understand and articulate these different roles invites disputes and impairs the board's effectiveness. The board also should establish committee charters that clearly define the committees' jurisdictions and responsibilities. It is especially detrimental for boards or board committees to extend their roles into management's purview—for example, when the audit committee begins to redo the financial statements or conduct its own audit.

Similarly, management must understand its role and that of the board; otherwise, board meetings can become consumed by routine or irrelevant matters that management should

be dealing with. Also, gaps can develop in areas that the board believes are part of management's responsibility but management assumes the board is handling. For example, the board establishes how much expenditure the CEO can authorize without requesting board approval, and it cannot permit ambiguity in that area; doing so would create room for constant friction between the board and the CEO.

The board's role does not include running the company. The board hires people for day-to-day management, oversees and monitors management and corporate activities, reviews and approves (or disapproves) key strategies and policies, and acts on significant matters after having fully informed itself. (See **Box 1.1.**)

Box 1.1: Board Responsibilities

The board's role and responsibilities typically include the following, among others:

- Approving a corporate philosophy and mission
- Nominating directors for election to the board
- Establishing an audit committee composed entirely or primarily of independent directors (depending on the jurisdiction)
- Selecting, monitoring, advising, evaluating, setting compensation for, and—if necessary—replacing the CEO and other senior executives, while ensuring an orderly and proper management succession
- Reviewing and approving:
 - **Management's strategic and business plans**
 - **The company's enterprise risk management program and systems of internal control**
 - **The company's financial plans, objectives, and actions—including distributions to shareholders, significant capital allocations, expenditures, and other material financial obligations**
 - **Material transactions not in the ordinary course of business, and making recommendations to shareholders when their approval of such transactions is necessary**
- Monitoring corporate performance against strategic business plans
- Determining the limits of authority and expenditures and board delegations for the CEO and senior management.
- Helping ensure ethical behavior and compliance with laws and regulations, accounting and auditing principles, and the company's own governing documents
- Assessing its own effectiveness in fulfilling board responsibilities

Based on: The Conference Board, *Corporate Governance Handbook* (2007).



2

ESTABLISH ORDERLY BOARD PROCESSES

Orderly processes and procedures help create an environment that not only permits but also encourages discussion and debate. By contrast, disorganized, chaotic meetings not only impede the substantive aspects of the board meeting but also create numerous irritants. Two things happen quickly:

- First, confusion will reign, and from that confusion will spring misunderstanding, frustrations and even anger. *What is the business at today's meeting? In what order do we consider things? Is there follow-up from the last meeting?*
- Second, time will run short, discussion and debate will be compromised, and some important matters will not be considered.

Board meeting organization must include a clear protocol for how meetings will be conducted and how the discussion will occur. Every director must have an opportunity to participate in discussions and debates.

Some boards will establish their own protocols that lay out the chair's role, procedures for calling on those who wish to speak, debate procedures (rebuttal and counter-rebuttal), and clear rules for how to ask directors to end their remarks if they do not abide by the board's rules.

For boards that don't want to develop their own rules for discussion, Robert's Rules of Order is one solution. Published for the first time in 1876 by Henry Martyn Robert, it is one of the most commonly used meeting protocols.

One caveat: The decision-making process under Robert's Rules tends to favor the majority and does not factor in the instability that can result from having unhappy minorities. To prevent frustrations and, consequently, disputes from building, boards are increasingly using more consensus-based processes for decision making, in which voting would be a last resort for decisions. (See **Box 2.1.**)

Box 2.1: Robert's Rules—And Breaking Them

Ten Basic Principles of Robert's Rules of Order

Robert's Rules of Order is used by parliaments, boards, and many other decision-making bodies to establish a procedure for discussing and making decisions.

- All members have equal rights, privileges, and obligations; rules must be administered impartially.
- The minority has rights, which must be protected.
- Full and free discussion of all motions, reports, and other items of business is a right of all members.
- In doing business, the simplest and most direct procedure should be used.
- Logical precedence governs the introduction and disposition of motions.
- Only one question can be considered at a time.
- Members may not make a motion or speak in debate until they have risen and been recognized by the chair and thus have obtained the floor.
- No one may speak more than twice on the same question on the same day without permission of the assembly. No member may speak a second time on the same question, if anyone who has not spoken on that question wishes to do so.
- Members must not attack or question the motives of other members. Customarily, all remarks are addressed to the presiding officer.
- In voting, members have the right to know at all times what motion is before the assembly and what affirmative and negative votes mean.

Source: California State University, Chico. Available at <http://www.csuchico.edu/sac/studentOrganizations/parliamentaryProcedures.shtml>.

Breaking Robert's Rules

In the book *Breaking Robert's Rules*, authors Lawrence Susskind and Jeffrey Cruikshank explain that deciding on matters is not as simple as voting. They offer the following five steps to improve decision making so that agreements can be reached and implemented more effectively. Boards may want to consider these steps when developing their organizational processes:

- *Convening*: Agreeing to a particular decision-making process.
- *Assigning roles and responsibilities*: Clarifying who is in charge. Specifying ground rules. Defining the role of the facilitator/chair.
- *Facilitating group problem solving*: Generating mutually advantageous proposals and confronting disagreement in a respectful way. Ensuring that a range of solutions (including the ones no one thought of) are considered to address the concerns of all participants/members.
- *Reaching agreement*: Coming as close as possible to meeting the most important interests of everyone concerned, and documenting how and why an agreement was reached.
- *Holding people to their commitments*: Having participants/members do what they are supposed to/agreed to do. Keeping participants/members in touch with each other so that unexpected problems can be addressed together.

Source: Lawrence Susskind and Jeffrey Cruikshank, *Breaking Robert's Rules* (New York: Oxford University Press, 2006).

At a minimum, good board organization should include routines for information flow both to and within the board, preparation of materials in advance of meetings, and an orderly environment in which the board can conduct its business. The following are some good practices for preparing board meetings:

- ***The agenda and its content.*** A carefully constructed agenda determines the issues under discussion and ensures a basic order to meetings. The agenda is generally put together by the chair and the corporate secretary, with input from the CEO. Any director can request that the chair include a matter on the agenda.

A problem for many boards is having directors overwhelmed with mundane and administrative issues, which leaves too little time for substantive discussions on matters of strategic importance. This imbalance breeds resentment among directors, who feel that they cannot fully perform their duties and participate in critical decision making.

Agendas should strike a balance between reviews of past performance and forward-looking issues. Strategic issues require ample time for debate, so the agenda should allocate sufficient discussion time.

The agenda should show the amount of time allocated for each item, and it should limit the number of items, so the board will have sufficient time for deliberations on each one. A study of 1,400 companies by 3i Group plc, a large venture capital company in the United Kingdom, showed that 59 percent of boards have 8 to 10 items on the agenda. Only 1 percent have more than 13 items.

- ***The agenda annual calendar.*** To keep the “peaks” and “troughs” of a board’s business within reasonable limits, many boards develop an agenda annual calendar. This allows sufficient time for specific issues during meetings throughout the year. Certain items will need to be fixed according to the financial reporting cycle, but less time-specific topics can be included on the board agendas when there are fewer items to discuss.
- ***Board meeting frequency.*** Typically, 6 to 10 board meetings per year will be sufficient, particularly when committees meet between board sessions.

- ***Board meeting duration.*** The length of meetings should be tailored to the issues requiring board consideration. Ideally, board meetings should last no more than four hours and conclude with lunch or dinner, so members can continue more informal conversations.

Note: It is common for boards to have lengthy strategy discussions, which are often held as separate, dedicated meetings. (See “5. Step out of the Boardroom to Gain New Perspectives,” on page 19.)

- ***Minutes.*** Minutes record what actually happened at a meeting in the order in which it happened, regardless of whether the meeting followed the written agenda. Minutes also serve as important reminders of action to be taken between meetings. Aim to keep them short and to the point, usually not more than four pages.

At a minimum, the minutes must contain 1) meeting location and date, 2) names of attendees and absentees, 3) principal points arising during discussion, and 4) board decisions. Include dissenting members’ views in board meeting minutes to show that all positions have been heard and that the board values open discussions.

- ***Meetings of non-executives.*** Many companies with unitary boards have developed the practice of regularly scheduling so-called “executive meetings” of the non-executive directors.⁵ The purpose is to provide non-executive directors a chance to voice any suggestions or concerns about the functioning of the board—or discuss any other board matters—without the presence and possible influence of other directors.

These sessions typically are held on the same days as the regularly scheduled board meetings. The senior independent director or the lead external director usually presides at these sessions. The following are some likely areas of focus for discussions held solely among non-executive directors:

- Annual meeting with the auditor
- Evaluation of the executive directors (and sometimes senior management), and establishing the executive directors’ salary
- Conflicts between two board members, or serious

⁵ Certain regulatory restrictions may apply regarding when and how executive sessions can be set up.

criticism of one board member by another

- Investigation into concerns about an executive director

An effective way to avoid the feeling that “an executive session means bad news” is for the board chair to routinely put executive sessions on every agenda, or on four agendas per year.

The meeting’s minutes should indicate that the board met in an executive session and should identify the discussion topic, although the specifics may remain confidential. Furthermore, one director attending the executive session should be designated to let the CEO know the results of the executive session and any issues arising. This can be a highly sensitive process and is one that can generate a great deal of tension unless there is strong trust between the board, in particular the chair, and the CEO.

3

ENSURE THE PROPER FLOW OF INFORMATION

Directors have a fiduciary duty to make decisions *after* considering all material information that is reasonably available. A board's well-constructed information system supports a healthy bond between the board and management. It helps ensure that the board has the basic facts necessary for a healthy discussion and debate. Typically, boards need two kinds of information:

- **Ongoing information** contributes to the board's oversight and monitoring of the company and its business. For ongoing information flows, boards and management should:
 - Agree on certain performance indicators that give management and the board a snapshot of how the business is doing and the outlook for the short, medium, and long terms;
 - Determine frequency of reports with performance and risk indicators and their publication format; and
 - Determine other informational materials (such as press releases, certain regulatory filings or reports by investment analysts on the industry or company itself) that the board may want to receive regularly.
- **Specific information**—for proposals and actions—helps directors understand and evaluate proposals for board action so they can make knowledgeable decisions. (See **Box 3.1.**)

Box 3.1: Briefing Papers

Board materials should be summarized and formatted to allow board members to readily grasp and focus on the most significant issues in preparation for the board meeting. Papers relating to *specific agenda items* should be clearly structured, with headings such as “purpose,” “background,” “risks,” “issues,” “impact,” and “recommendations.” Briefing papers should be:

- *Short, concise, and material.* Board papers associated with a particular agenda item need not be more than four to six pages, with any further detail provided in annexes. Many directors privately complain that their board papers are often twice as long as they should be.
- *Timely.* Information should be distributed, preferably in the hands of directors, at least five business days in advance. This allows board members—particularly non-executive directors, who are not as familiar with the business as executive directors are—to fully consider the issues before the meeting.
- *Focused and action-oriented.* The papers should present the issue for discussion, evaluate the risks of each identified alternative, offer solutions for how to effectively address the issue, and provide management’s view on which action to take. It should be clear what is required from the directors. Is this a matter for decision, for information only or to be noted (if exercised within existing CEO/management authority)?

If a proposal is more complex or requires additional explanation, the board should consider delegating the matter to a board committee or arranging one-on-one briefings of each director by the proposal’s promoter.



4

ENCOURAGE A BOARD CULTURE THAT ALLOWS FOR EFFECTIVE DISCUSSIONS, DEBATES, AND DELIBERATIONS

Sometimes impediments to discussion involve structural and organizational issues. Constructive inquiry, discussion, debate, and decision making require a conscious effort. When the board environment is comfortable and the tone encourages creative problem solving, people will challenge assumptions, ask probing questions, and make suggestions that contribute to innovation and informed decision making. To support the kind of environment that prevents disputes and promotes effective deliberations, boards must develop a boardroom culture based on *collegiality* and *civility*.

Collegiality promotes respect for one another and for each member's ability to express views, regardless of whether anyone else embraces those views. It permits participants to be more open to new ideas, rather than being defensive of their own conclusions. In reality, a board is a group of people—each with an equal vote in the decision-making process. A democratic environment should prevail; no one person should rule. The environment should foster flexibility and collaborative thinking, and it should encourage directors to hear different views, argue the merits, and ultimately arrive at a consensus.

Civility complements collegiality. Civility involves adherence to certain manners and practices for interaction among individuals. A civil environment does not preclude animated debate, deeply held beliefs, emotional speech and action, or passionate convictions. But it does mean that the board will not tolerate personal attacks or behavior designed to embarrass another person. A lack of civility can too easily trigger antipathy and anger, thus inhibiting free discussion and debate. Lack of civility also can lead to destructive interpersonal relationships and, in the process, create an additional layer of emotional content that will have to be addressed if disputes are to be resolved.

Civility is especially important as boards become more diverse. Diversity facilitates creative problem solving and provides exposure to a wide range of perspectives, yet diversity without civility can produce misunderstandings and disagreements based on cultural and other differences.

However, heavy preoccupation with civility can create its own problems. When people become overly concerned about avoiding confrontation or embarrassment, thinking they are being civil, they sometimes do not address matters directly, or they avoid discussing certain issues.

Directors' *personalities* also can affect the board culture in ways that may stifle debate. Obviously, a domineering director needs to be reined in, but it is also important to establish a culture that draws out directors who are shy about speaking up. The following are some examples of personal inhibitions that may keep people from openly expressing their ideas:

- Discomfort about appearing to be the sole objector
- Concerns about appearing to be noncollegial, or not being a team player
- Reluctance to challenge the CEO or another dominant personality on the board
- Tendency to avoid issues that are emotionally sensitive
- Fear of appearing ignorant or uninformed

- Peer pressure
- “Groupthink”—where people conform their views to what they believe is the group’s consensus rather than engaging in debate on the problems or issues that must be confronted
- A director who, for any reason, feels inhibited about speaking up will become frustrated. Frustration easily festers and becomes anger, creating dissonance and dysfunction among directors.

The *composition of the board* can directly affect its collegiality and civility. This makes the nomination of directors a critical factor in establishing the culture of the board. (See **Box 4.1**.) Also, an *effective board chair* can do much to establish and maintain a healthy balance in director participation. (See **Box 4.2**.)

Box 4.1: Factors to Consider for Director Nominations

- To promote a collegial environment that facilitates the board’s work, a board—and especially its nomination committee—should:
- Encourage directors to meet with potential directors before they are nominated, and to weigh in on the nomination process. For example, the non-executive directors (NED) would individually meet with the proposed new NED and the entire board will have an audience with a proposed executive director;
- Perform thorough background investigations of potential directors, and obtain as much information as possible on how the potential directors have functioned in group decision-making settings;
- Avoid nominating people who are reputed to argue for argument’s sake;
- Avoid nominating people who, because they are fearful of making decisions, prolong debate and resist developing collaborative solutions; and
- Make sure the board has at least some people with skills and training in conflict resolution, consensus building, negotiation, and mediation.

Box 4.2: Role of the Chair

For managing the board's business and acting as its facilitator and guide, an effective board chair is absolutely essential. While conducting the meetings, the chair should:

- Maintain control of the proceedings without dominating discussion, treating all directors equally. Unfortunately, it is not uncommon for a chair to make his or her opinion known before allowing all the directors express their views, thus preventing an honest exchange of ideas.
- Facilitate decision making by stimulating focused debate, drawing on all contributions, encouraging constructive discussion, and ensuring that genuine disagreements are aired and resolved. Skillful questioning helps clarify issues and encourages the full participation of the directors.
- Steer the board toward consensus. A good chair will always aim for a consensus decision, not just one based on majority vote. (For more information, see *Building Consensus*, on page 26.) In some jurisdictions, company bylaws allow the chair to exercise the "casting vote" to break a voting tie on the board. Even if allowed to do so, the chair should avoid exercising this right, as it exacerbates tensions on the board.
- Ensure that the decisions that are made are properly understood and recorded.

5

STEP OUT OF THE BOARDROOM TO GAIN NEW PERSPECTIVES

Governing a company is a demanding exercise, and board meetings can become consumed by urgent issues of the day. An effective way to put it all into perspective is to step out of the confines of the boardroom. Doing so provides opportunities for directors to accomplish important objectives, such as the following:

- Get to know each other in less formal settings.
- Evaluate board performance and needs.
- Focus on strategic development of the company.
- Build consensus and resolve emerging disagreements before they can become problems.

Effective debates and deliberations require a certain level of familiarity and trust among board directors. Boards need to ensure that opportunities exist for directors to know one another in informal, comfortable surroundings. Here are some suggestions:

- Arrange a dinner for all directors before each board meeting. Consider assigning places for each director to sit at dinners, and change the seating arrangement to ensure that each director has an opportunity to sit next to—and therefore to talk with—every other director over the space of a year.

- The non-executive chair (or the lead director, if the chair is a member of management) should meet over a meal at least once annually with each director individually—to hear the director’s views about the company and board. This interaction also can bring to the surface any issues about which there is tension or irritation.
- The CEO should meet over a meal at least once annually with each director—to hear thoughts and ideas that the director has about the company, management, and the CEO’s performance. The NED chair, if there is one, needs to be closely associated with this so that CEO is not misinterpreted to be lobbying against the chair where there might be some residing tensions or issues.

Board *assessments* and *retreats* provide excellent platforms for identifying interests, surfacing issues, promoting discussion, and facilitating collaborative decision making. In many companies, these processes have become standard practice and thus fit neatly into the board calendar of activities and also offer the opportunity for the board to meet with not just the executive directors but other senior management.

Board Assessments

Board assessments are not evaluation scorecards or grading sheets. There is no magic formula for a board (or committee) assessment. The objective is to elicit each board member's candid views about how the board operates and its effectiveness as a group. The assessments/evaluations vary greatly in scope and purpose. They can focus on anything from board practices and processes to the performance of each director.⁶

Typically, the assessment involves either a written survey or a confidential interview of each board member, often conducted by the chair, lead director, or an external advisor. Regardless of the format, the key to a successful evaluation is to create an environment in which respondents will be candid. They must be assured that their responses cannot be attributed to them and that they will not be personally embarrassed in front of the whole board by what anyone else in the group may say about them.

The evaluation must be followed by a report to the full board and, when appropriate, to individual directors. If something is revealed that could be personally embarrassing, only the person who is the object of such a comment should be shown the comment.

People have a natural inclination to resist evaluation. One technique for reducing this resistance is to recast assessments as *performance improvement plans*. These plans emphasize that the objective of the exercise is to *improve* performance rather than to *criticize* performance or behavior. Treating reviews as a forward-looking planning process, rather than a backward-looking critique, may invite a more goal-oriented and positive attitude toward the process.

Board Retreats

Board assessments are not self-executing. Once the assessment surfaces and identifies issues of concern, it's time for the board retreat. The retreat becomes a venue for group discussion of the assessment results and formulation of action plans by which disagreement and disputes can be resolved.

Board retreats focus on important matters in a setting that does not have the time pressures or other distractions involved in regular board meetings with their typically lengthy agendas. Generally, participants identify common concerns early in the process. With a clear focus on the corporate vision and mission, they analyze options, prioritize interests, and formulate strategies. The outcomes include agreements on future priorities and increased focus within the board. (See **Figure 5.1**.)

Some boards prefer to have the chair or a trusted member of management to conduct the retreat. The problem with this approach, of course, is that the facilitator's preferences are known to members of the board, discouraging innovation and candor.

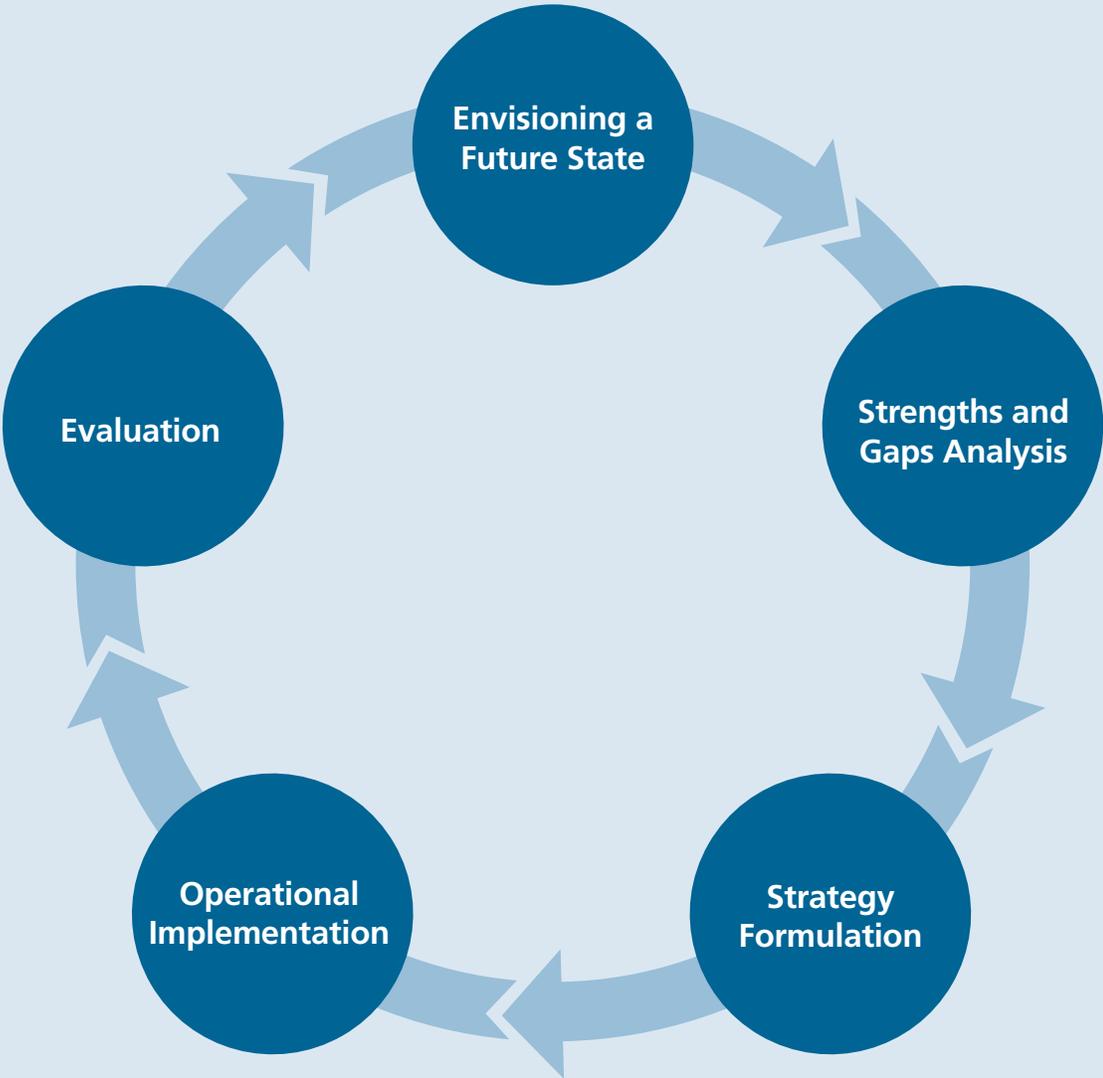
To help make board retreats more effective, the board can call on an external expert or facilitator. This neutral or impartial third party brings objectivity to the process, giving all participants assurances that the proceedings are not skewed for or against one position or another. This can be a welcome change from regular board meetings. For example, if one or two strong personalities are allowed to dominate on the board, a good facilitator may ensure that dissenting opinions are at least fully heard during assessments and retreats.

A skillful facilitator can identify, with the full group's affirmation, issues in dispute and issues that have been resolved. This process permits a collaborative resolution to matters in dispute. As points are resolved, a written record memorializes the consensus derived.

⁶ See Elise Walton, "Leveraging Board Assessment for Sustained Performance," *Private Sector Opinion Series* (Washington, D.C.: IFC Corporate Governance Group, 2014).

Figure 5.1: Board Retreats

Retreats provide regular venues for problem solving and strategic planning. The board’s strategic planning process typically includes the five phases shown below.



Source: Adapted from Global Corporate Governance Forum, *Corporate Governance Board Leadership Training Resources, Part 3, Module 1. "Strategic Leadership"* (Washington, D.C.: IFC, 2008).



6

APPLY DISPUTE RESOLUTION SKILLS AND TECHNIQUES

Dispute resolution techniques, borrowed from negotiation and mediation, can help create the desired collegial environment—to encourage discussion, debate, and the free flow of ideas. They also can help boards develop an orderly process for decision making and consensus formation on specific issues the board has to contend with, which in turn improves the board’s all-around performance.

Typically, the chair (or lead director)—being particularly attuned to board relations—is expected to mediate between disputing directors. But sometimes other directors who have a collaborative conflict-management style may draw on mediation techniques (perhaps without being aware of doing so) to find common ground. Such peacemakers will ask questions, listen attentively, and encourage parties to resolve differences.

Ultimately, however, the board is collectively responsible for managing disputes in a timely, constructive manner. So all directors should be able to strengthen the board’s corporate governance through dispute resolution practices. **Table 6.1** contrasts the behaviors of people with or without skills in conflict resolution. And **Figure 6.1** provides a quick look at some of the interpersonal skills that help directors strengthen a board.

Even strong boards may encounter disputes from time to time. Throughout a dispute cycle, certain interpersonal skills and expertise can help board directors engage each other constructively and manage tensions. Chief among these skills are *effective communication*, *respect for cultural sensitivities*, *consensus building*, *managing emotions*, and *constructive disagreement*. The rest of this section examines each of those skills.

Communicating Effectively

One of the biggest communication mistakes—on boards and in general—is to assume that we know how others receive what we are trying to communicate. People exposed to the same information can end up with completely different impressions and ideas. This is why the process of perception—how people receive, organize, interpret, and retain information transmitted to them from another person—can be a key obstacle, especially in multicultural environments, which modern boards increasingly are.

Communication also suffers when the hearers (or readers) tend to fill in any information gaps with something they already know. This process of closure, or aversion to ambiguity, fills the void with familiar concepts or information, even if that information is neither relevant

Table 6.1: Conflict Resolution Skills Ladder

UNSKILLED INDIVIDUAL	CONFLICT	SKILLED INDIVIDUAL
<ul style="list-style-type: none"> • Inflexible • Personal needs dominate • Tries to use power to dominate (through aggression) or to withdraw to engage sympathy 	<p>CAN NEGOTIATE A WIN-WIN SOLUTION</p> <p>6</p>	<ul style="list-style-type: none"> • Flexible • Open-minded • Assertive to look after personal interests
<ul style="list-style-type: none"> • Limited to “fight or flight” options • Focuses exclusively on own interests • Argues for a position (which can be disguised as interests) 	<p>CAN GENERATE VARIOUS SOLUTIONS</p> <p>5</p>	<ul style="list-style-type: none"> • Generates a variety of options • Finds options that include both parties’ interests
<ul style="list-style-type: none"> • Unaware of others’ feelings • Cannot read feelings accurately • Cannot “hear” the other person’s interests • Sees the other as “bad guy” • Believes empathy means agreement/weakness 	<p>CAN EMPATHIZE/ TAKE PERSPECTIVE</p> <p>4</p>	<ul style="list-style-type: none"> • Accurately reads others’ emotions • Responds sensitively and appropriately • Listens to others’ interests • Knows the difference between empathy and agreement
<ul style="list-style-type: none"> • Only expresses own position (advocated solution) 	<p>CAN IDENTIFY AND EXPRESS OWN INTERESTS</p> <p>3</p>	<ul style="list-style-type: none"> • Knows the difference between positions and interests • Expresses own interests regarding wants/needs/fears/ concerns
<ul style="list-style-type: none"> • Cannot verbalize own thoughts and feelings • Unaware of own thoughts and feelings (blames others) 	<p>CAN VERBALLY EXPRESS OWN THOUGHTS AND FEELINGS</p> <p>2</p>	<ul style="list-style-type: none"> • Has a large feelings vocabulary • Can identify own thoughts and feelings • Can experience emotion without losing control
<ul style="list-style-type: none"> • Cannot contain/manage emotion • Yells, screams, fights, dissolves into tears, withdraws 	<p>CAN CONTAIN/MANAGE STRONG EMOTIONS</p> <p>1</p>	<ul style="list-style-type: none"> • Can experience emotion without losing control

Source: Adapted from: M. Trinder and E. Wertheim, “Training Teachers in Building Empathy and Compassion in Young People” in M. Kostanski (Ed.) *Proceedings of the Victorian Branch Australian Psychological Society Annual Conference (2005)*. Available at: <http://www.latrobe.edu.au/psy/research/erisl>.

Figure 6.1: Important Interpersonal Skills



nor correct. This is why effective communication skills involve more than just imparting information.

Communicating well starts with “active listening.” Good communicators are good listeners. Being attentive and receptive to others’ views helps ensure collaborative, two-way communication. The process of active listening requires a range of skills: observing and understanding others’ nonverbal communication, awareness and use of your own nonverbal signals, appropriate use of silence and

minimal verbal prompts, reflection of feelings, paraphrasing and summarizing, and careful use of questions.

These skills might sound easy, but in reality their appropriate application requires careful observation, good judgment, and excellent timing. Mastering these skills requires extensive training and practice—they constitute the core of the joint IFC-CEDR training program for directors on managing disputes and difficult conversations on the board. However, directors can start practicing *some*

elements of those skills—such as paraphrasing, reframing, summarizing, and questioning—on their own.

- **Paraphrasing** is briefly stating in your own words the essence of what you think someone has just said. Here are some examples of phrases that introduce a paraphrase:

So what you're saying is. . .

What happened was. . .

You are telling me that. . .

A paraphrase should be nonjudgmental and should not introduce interpretations or your own thoughts. Nor should it just repeat verbatim what the person said. Here are some uses of paraphrasing:

- To check to be sure you have accurately understood what was said. This helps prevent (or correct) miscommunication and false assumptions.
 - To show that you recognize, acknowledge, and accept the thoughts of the other person without making a judgment about what you think you have heard.
 - To help defuse anger and cool down a crisis.
 - To help you remember what has been said.
 - To provide an opportunity for the other person to hear his or her own message more clearly. This can lead to further exploration and, often, the development of a fresh appreciation of the issue.
- **Reframing** changes the words used or the way ideas are presented—to cast them in a different light. It offers a new and more positive view of the situation. Reframing can take several forms:
 - Taking the sting out of language—detoxifying or depersonalizing it;
 - Interpreting actions from a different perspective—for example, focusing on what is needed for the future rather than what has not worked in the past;
 - Presenting claims or proposals in a different way—to make them more palatable; or
 - Rewording demands made by one party of another—for example, the idea of apologizing may

be rejected on principle, but an expression of regret may be acceptable.

Here are some examples of reframing:

Speaker: *He's a liar and a cheat.*

Listener: *So you feel misled, and it's hard for you to trust him.*

Speaker: *I assess that I have a 75 percent chance of winning.*

Listener: *So you have a 25 percent chance of losing?*

Speaker: *They write very poor reports.*

Listener: *So you want the reports done differently in the future?*

- **Summarizing** draws together the main threads of what a person has said. For example, a summary is useful for clarifying a lengthy or elaborate explanation, checking progress before moving on, or identifying an underlying theme that may provide new insights. The summary should not be the listener's interpretation of what has been said, but rather it should draw on the other person's own words and be recognizable to the speaker as an accurate account. When summarizing, it is important to allow the other party to correct or add to the summary.

The following are some of the benefits of summarizing:

- A summary shows that you have been listening attentively and want to understand what the other person thinks and feels about the situation.
- It allows you to check your perception of the situation and clarify what you think you have heard.
- It may connect confused and fragmented thoughts and feelings and bring some order to them and avert any ambiguity.
- It gives feedback to all parties about what they have said, and it can alert them to an interpretation of conflicting or contradictory thoughts, feelings, and ideas.
- Summarizing is a way to focus on particular issues and can help the parties begin making decisions about priorities, what needs to be tackled first, or what concessions or proposals they are prepared to make.

Summarizing is an especially useful skill for the board chair. Being able to summarize the discussion, and decision agreed if applicable, helps move it forward.

- **Use of questions** is a tool that must be applied sensitively. Different forms of questions will be appropriate at different times. For instance, *open-ended* questions (“What do you think about. . .” “Tell me more about. . .”) encourage a meaningful, extended response. On the other hand, *closed-ended* questions (requiring or allowing for a one-word or yes-or-no reply) may have the effect of limiting or “leading” the discussion.

Careful *framing* of a question is important, for questions can:

- encourage a party to talk,
- show empathy and support.
- But questions can also:
 - indicate partiality, judgment, criticism,
 - seem prying or irrelevant,
 - become an interrogation.

Timing and *context* are also important in the use of questions. In deciding when and how to ask questions, you need to take into account the listener’s level of trust. For example, questions that are probing and challenging would not be appropriate right away, before a party is ready to trust you with that level of information or exposure. *Open-ended* questions are particularly useful in the exploration phase. *Closed-ended* questions are more appropriate when checking and summarizing and in the later stages. *Hypothetical* questions can be used at any stage for trying out ideas.

Respecting Cultural Sensitivities

Culture can be defined as a set of learned beliefs and behaviors that shape the ways individuals and groups view and experience the world. All people—including directors—bring to their social encounters unique worldviews, local perspectives, and behaviors shaped by the culture of their origin. These views and behaviors are learned in childhood and evolve through various affiliations, such as religion, ethnicity, class, and voluntary and professional organizations.

A board that includes talented directors with varied technical, ethnic, social, and cultural backgrounds is more likely to question assumptions and to weigh various consequences, leading ultimately to more far-sighted decisions. However, although diversity on the board is an asset, it can also lead to more frequent disagreements, which may be deepened by cultural differences.

Cultural skills are heavily dependent on keen observation and sensitivity to colleagues’ perceptions of respect. During board meetings, for example, some directors may be time-conscious, efficient, and task-oriented; for them, time management is an element of professionalism. Other directors may place higher value on board hospitality and relationships; for them, strong emphasis on board tasks and efficiency is uncultured and disrespectful.

The most difficult cultural differences to overcome are not about behaviors, such as whether to shake hands, but rather about issues related to shared and enduring values and beliefs associated with a particular group or community. Board directors, and especially chairs and lead directors, should be cognizant that cultural differences may become obstacles to agreement. They should be alert to any signs of one group imposing its values or beliefs on the board—as well as any hint of cultural superiority or disrespect, especially toward minority groups.

Building Consensus

For a company to function properly, the board needs to be effective in resolving issues and making decisions. Chairs and lead directors must ensure that the board performs these actions well. More and more boards are reaching decisions through consensus, a voluntary agreement following the deliberation and synthesis of different propositions. Generally, consensual decisions are less divisive than voting, which requires directors to take opposing yes-or-no positions. However, the consensus process tends to take more time than voting.

Consensus building should not be confused with *groupthink*, where directors follow the general trend of thought without questioning decisions. Consensus building is about working with directors who hold opposing positions at the outset—and helping them come to a mutually beneficial and sometimes innovative agreement. As the poet Ralph Waldo Emerson

once wrote: “Do not go where the path may lead; go instead where there is no path and leave a trail.”

Of course, consensus building requires the good communication skills described above. It also requires the following:

- Bringing issues to the surface;
- Analyzing and finding patterns for organizing the information;
- Generating alternative solutions;
- Prioritizing options, using a cost/benefit assessment; and
- Reaching agreements that include contingencies—and results that can be monitored.

Consensus building can occur outside the confines of board meetings—in retreats, executive sessions, and other less structured settings. The chair (or lead director or board member who acts as a peacemaker) may need to work behind the scenes and organize private meetings to find common ground on contentious issues. This requires time and commitment.

Managing Emotions

Emotions are intrinsic to conflict although not readily apparent—especially in the boardroom. In conflict, emotions are frequently translated into something more acceptable, such as making judgmental statements (“you are mistaken”), attributing intentions to others (“you refused to disclose this information to me”), or serving up solutions (“this is what needs to be done”). Directors need to be aware of any biases. Strong analytical skills and the ability to isolate emotional issues from substantive ones are essential in any business role, but are particularly critical in resolving disputes.

Yet in many cases the solution to a conflict will be difficult without acknowledgement of the feelings in play. This doesn’t mean that directors should be “emotional.” But solutions to disputes require communicating feelings—in a professional manner—before refocusing the discussion on the directors’ fiduciary responsibility to act in the best

interests of the company and its shareholders. Here are five tips for positively influencing the emotional climate during a conflict:⁷

- **Show appreciation for all parties.** Demonstrate an understanding for others’ positions and recognize the value of what they think, feel, or do. This does not mean that we have to agree with their position.
- **Create a bond.** Share information about common interests and ask others about personal aspects of their work or life.
- **Respect the parties’ autonomy.** People like to make independent decisions. Give others the space to express their views. Talking too much, for example, can threaten the autonomy of others.
- **Acknowledge the other party’s status.** Status helps clarify a person’s position relative to the others.
- **Highlight the other party’s role.** Board directors each play an important role. Each role must have substance, and the directors must be respected for their roles.

Disagreeing Constructively

At times, a board director has a serious concern about a board decision or the standards on which the decision was made. Constructive dissent is the ability to challenge the majority view in a useful way. This skill can help prevent or limit groupthink, which precludes dissent and sound decision making. The risk when someone challenges groupthink is that the majority will be critical and try to silence or pressure the “outlier” to conform.

Disagreeing constructively requires courage and effective assertion. Various methods are used to pressure someone into agreement, including discounting expertise or using such statements as “be a team player.” Directors sometimes compromise their values and professional standards to maintain friendly, cohesive relations within the dominant group. The easiest response to groupthink pressure is to fall silent, hoping that another director will take a leadership role in addressing the issue.

⁷ Roger Fisher and Daniel Shapiro, *Beyond Reason: Using Emotions as You Negotiate* (New York: Penguin Books, 2005).

A clear understanding of corporate governance responsibilities (and liabilities) will strengthen a director's resolve in challenging the board's majority opinion. The corporate secretary's documentation of dissent during board meetings provides procedural support for directors who dissent, as there is a record of the topic, the risks identified, and the board's responses.

Constructive dissent is most effective when proposed with careful preparation. A director is more likely to gain serious attention when presenting information with confidence using facts, examples, comparisons, and risk assessments. The corporate secretary is a vital resource for guidance in procedural matters, regulations, and precedents. Effective approaches for challenging a majority view include the following:

- Offer a concise statement of concern and counter proposal.
- Offer factual support.

- Provide clear examples.
- Demonstrate active listening.

Respond with constructive feedback recognizing the valid contributions and views of others (but reaching a different conclusion on the matter in question).

Preparation may also include talking with the chair in advance of the meeting to avoid surprises. If a director raises a concern, complete with substantiating information and evidence of risk, and the board does not respond, a director may ask for an expert's assistance, seek a mediator, or, if warranted, resign from the board.

This section has looked at dispute resolution skills from several angles. **Box 6.1** provides a brief review of the interpersonal skills needed on the board. And **Box 6.2** offers a summary of techniques for defusing disputes in the boardroom.

Box 6.1: Assessing the Board's Interpersonal Skills

Board retreats provide opportunities to assess individual and collective interpersonal skills and expertise that improve governance practices and help manage disputes. The set of questions below can serve as a guideline to assess those skills:

- Are the board directors effective communicators?
- What are their strengths and weaknesses?
- Are board discussions focused yet sufficiently open to encourage a broad range of viewpoints?
- Are there opportunities for individual board members to make presentations and lead discussions, particularly the ones on issues relevant to their committee responsibilities and areas of expertise?
- Does the chair balance the extroverts and introverts to ensure open participation in board deliberations?
- Do board directors relate well to one another and to senior management? If not, what are the problems and their sources?
- Are social, cultural, political, economic, or personal factors creating tensions among board members and senior management?
- Have tensions among directors obstructed the board's ability to function? If so, why?
- What steps has the board taken to defuse personal animosities among board directors?
- Does the process that the chair or lead director uses to consider issues provide opportunities for reflection, analysis, debate, and consensus building?

Box 6.2: Techniques for Defusing Disputes in Boardrooms

- **Listen actively.** As people communicate, pay close attention and demonstrate genuine interest by asking questions, summarizing key points, and linking relevant ideas and experiences.
- **Use open-ended questions.** Ask questions that require more than yes-or-no answers. Open-ended questions encourage speakers to reveal their concerns and interests. Such questions usually begin with *who*, *why*, *what*, *how*, *when*, or *where*.
- **Clarify reasons.** Encourage cooperation by clarifying shared goals and confirming objectives. Do this early in meeting discussions.
- **Be aware of body language.** Show your interest and desire to communicate through friendly, open, and attentive facial expressions and posture. Notice others' body language.
- **Speak on behalf of yourself.** Use "I" statements, so listeners understand that you are not making universal statements but only expressing your own opinions, sharing personal observations, and offering alternatives. Others may have different experiences, perceptions, and ideas. Phrases that demonstrate respect for differences include *I noticed*, *I suggest*, or *from my experience*.
- **Recognize others' positive ideas** through constructive feedback, and explain why their proposals are useful. If more helpful contributions are needed, be specific in your requests. Ask for practical suggestions to improve specific situations.
- **Stay calm** as you work professionally and diplomatically to defuse tension. At times, others will discount the value of your ideas, no matter how carefully you phrase your thoughts. People become defensive for many reasons, including circumstances beyond your control. When that happens, acknowledge and respect the different views. You have offered your perspective based on your experiences. Offer to meet at another time, when emotions have cooled, to continue the discussion.
- **Avoid misunderstanding.** Paraphrase other board members' statements to ensure proper understanding of their position. Allow them to acknowledge that your summary of their remarks is correct.
- **Allow others to "save face"** by reframing their statements in less confrontational terms to unlock disputes. Saving face is especially important in some cultures; but generally speaking, no one likes to be publicly embarrassed—especially in the boardroom. To save face, directors may take a defensive position, although they actually don't oppose a decision.



7

INCORPORATE ALTERNATIVE DISPUTE RESOLUTION INTO THE COMPANY'S CULTURE AND PRACTICES

Disputes will arise. Preparing in advance for dispute resolution is an essential board responsibility, so it is an important governance duty for the board to ask: Do we have an adequate mechanism in place to prevent and resolve disputes?

The parties to a business relationship, at the time they enter into that relationship, should always address the subject of how they are going to handle any problems or disputes that may arise between them. At this point, they have a unique opportunity to exercise rational control over any disagreements that may arise, by specifying that any disagreements be processed in a way that is likely to avoid litigation, preferably by agreeing on a dispute resolution “system” that will first seek to prevent problems and disputes, and, next, establish a process for resolution of any disputes.

– James Groton,
dispute resolution consultant
and arbitrator

The board's approach to disputes should reflect the company's culture as well as more tactical considerations as to what works best in particular circumstances. In the

corporate governance arena, the question also breaks down as to policies for internal versus external disputes. Can the same policy apply to both? Although the board may be involved in both categories of disputes, it may determine that, for business or tactical reasons, external disputes should be treated differently from internal ones.

Benefits of ADR for Resolving Corporate Governance Disputes

ADR is a framework of voluntary and amicable procedures for resolving corporate governance disputes more quickly and at less cost than by using traditional court litigation. It may take several years for complaints to be resolved through litigation, and courts may lack expertise in corporate governance or be overwhelmed with their caseloads.

Most importantly, there is overwhelming evidence, including from the IFC-CEDR survey, that boards strongly dislike resorting to litigation to resolve their differences. Adversarial litigation can be highly damaging to the company's performance, reputation, and value. By contrast, ADR allows for private and even amicable proceedings. Disputants assume greater ownership of

the way the dispute is considered and settled, since they actively drive the process. They also may stand a greater chance of continuing their business relations with one another after the ADR process is completed, because the conflict's intensity tends to be less adversarial than in court cases and outcomes can be a "win" for both sides. ADR procedures include negotiation, mediation, and arbitration. (See **Figure 7.1**.)

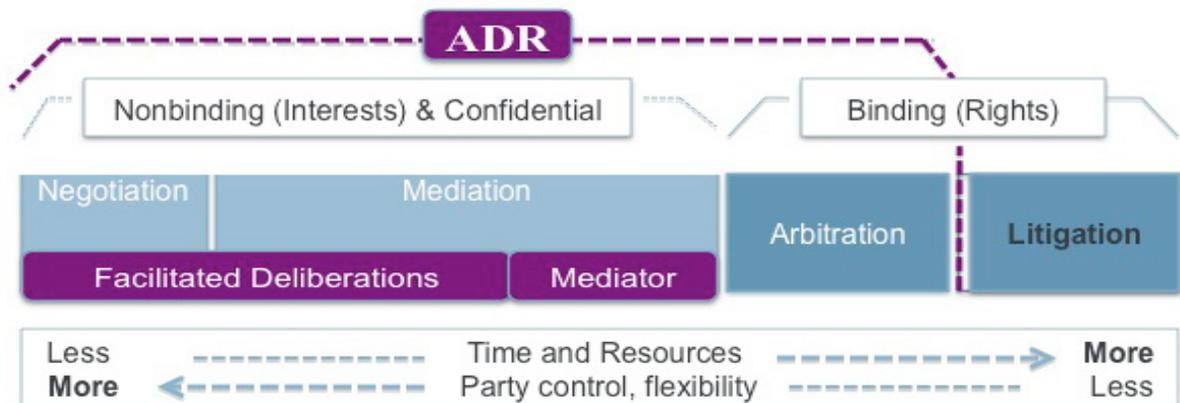
- **Negotiation** is an interactive process in which two or more parties with differing interests seek to agree to a better outcome or solution than a party could take on its own.
- **Mediation** is a voluntary, confidential process in which a respected impartial third party (mediator) actively helps the disputing parties work toward a negotiated agreement. The parties in mediation craft the terms of

an agreement by consensus, and the agreement may be enforced as a contract.

- **Arbitration** is a proceeding voluntarily chosen by parties who want the settlement of a dispute determined by an impartial arbitrator of their own mutual selection. The parties agree in advance that the arbitrator's decision, based on the case merits, will be final and *binding*. If the parties choose *nonbinding* arbitration, they retain the right to bring a claim before the court.

On the other hand, *litigation* is a legal or judicial process that may be appropriate when there is a question regarding the proper application of the law. Decisions are imposed and are supported by law and reasoned opinion. Those decisions may be appealed in court. (See **Table 7.1**.)

Figure 7.1: Alternative Dispute Resolution



Adapted from: *Alternative Dispute Resolution Manual: Implementing Commercial Mediation* by Lukasz Rozdeiczner and Alejandro Alvarez de la Campa. (Washington, D.C.: IFC, 2006)

Table 7.1: Comparing Mediation, Arbitration, and Litigation

MEDIATION	ARBITRATION	LITIGATION
Mediator Selected by parties	Arbitrator Selected by parties	Judge Imposed decision maker
<ul style="list-style-type: none"> • Informal • Voluntary 	<ul style="list-style-type: none"> • Formal and legal • Voluntary 	<ul style="list-style-type: none"> • Legal, with rigid rules • Involuntary
Private	Private	Public
Outcome: Mutually acceptable agreement	Outcome: Imposed decision, supported by reasoned opinion	Outcome: Imposed decision, supported by law and reasoned opinion

Mediation is the most common ADR technique. It is about mending fences and finding a constructive approach to conflict resolution—an approach that brings to the surface issues of mutual concern, reviews the various angles of the issue at stake, and allows the conflict to be used as a learning tool and as a basis for improved relations among the parties. Mediation enables parties to resume, or sometimes to begin, negotiations to agree to solutions based on interests, not positions, and to implement and monitor agreements. It has the following benefits:

- **Cost:** Transaction costs are considerably lower than those of adjudication.
- **Speed:** The process can start as soon as the parties agree to mediation. This rarely takes more than a few days. Experienced mediators estimate that even complex corporate governance cases take a maximum of five days to resolve.
- **Quality:** Mediators can be selected according to their skills and field of expertise.
- **Predictability:** The decision cannot be imposed on the parties.
- **Control:** The parties own the dispute and craft its solution.

- **Flexibility:** The parties can decide on the type of mediation and how to set up the procedure, including the timing and the location.
- **Confidentiality:** Parties can disclose only what they wish to. The content of the mediation and information exchanged usually remains confidential, and not generally a matter of public record, but the parties may agree to disclose the agreement.
- **Limited risk:** Parties do not have to settle, and they have the option to seek another form of dispute resolution, including a court decision.
- **Liability:** It doesn't have to be admitted to reach a settlement.
- **Enforceability:** While the process is nonbinding, the outcome may be enforced as a contract or registered as a consent judgment.
- **Voluntary:** Unless required by a court, the parties do not have to go to mediation. In all cases, parties do not have to settle.
- **Perspective:** Parties can gain a more objective, detached perspective on their positions before their views solidify and the battle lines are drawn (making

a resolution more difficult to achieve). Further, the parties' circumstances may have changed from those prevailing when the conflict occurred, thus allowing for an interim assessment.

Mediation is flexible and allows the parties to control both the process and the outcome of the dispute. The parties own their dispute and own the solution, and thus mediation fits the board environment particularly well.

Who Should Manage the Dispute Resolution Process?

The board needs to ask: Who should be in charge of managing and implementing dispute resolution strategy and policies? A board member, the chair, a board committee, the CEO, or possibly a senior executive could assume this responsibility. Once the strategy is developed, it is important to identify who can assume the role of peacemaker/mediator for different types of conflict that are likely to arise.

Not everyone is a talented peacemaker, is trained in dispute resolution skills, or is willing to take a leading role in the

company's dispute resolution. So the board should ensure that its skill profile includes the right mix of expertise and capabilities to manage corporate governance disputes properly, including one or two people who can act as a mediator if the need arises.

The best solution is to detect potential problems when they are small—and solve them before they become severe. In many situations, a board member can encourage and lead the board to articulate concerns and to press for early resolution to a potential dispute while the level of intensity is still low. If a board has not yet developed that degree of peacemaking capacity, it can call on an external expert, consultant, lawyer, or mediator to assist in applying and implementing the company's governance dispute resolution strategy. Whether internal or external, the peacemaker should have the mix of skills listed in **Table 7.2**.

Table 7.2: Peacemaker Skills Mix

DISPUTE RESOLUTION SKILLS	CORPORATE GOVERNANCE SKILLS
<ul style="list-style-type: none"> • Impartial, independent • Diligent, discrete • Responsible, patient • Trusted • Active listener • Nonjudgmental • Consensus builder • Understanding of the dynamics of disputes, resolution approaches 	<ul style="list-style-type: none"> • No vested interests • Knowledge of corporate governance framework • Knowledge of corporate governance best practices • Respected • Strategic • Leadership • Board experience • Understanding of issues in dispute

Key to choosing between an *internal* or an *external* corporate governance peacemaker is determining who would provide the highest level of trust and comfort to all the parties involved in the dispute:

- **Internal peacemakers**—*chair, independent director, corporate secretary, or an ombudsman*: Directors prefer handling their disputes behind closed doors. From within the company, those who are in the best position to handle corporate governance disputes are the board chair and the chairs of board committees. The board chair is naturally positioned to build consensus, prevent conflicts, and ensure proper resolution of disputes.

In their leadership roles, these potential internal peacemakers are naturally expected to develop consensus on organizational principles and procedures and apply discussion protocols. The responsibilities of the nominating/governance committee chair make that person particularly well-positioned to create dispute resolution structures, policies, and processes.

- **External peacemakers**—*negotiator, mediator, consultant, standing neutral, or an arbitrator*: Even though they may have a strong peacemaker within their ranks, boards should also consider drawing on external professional dispute resolution expertise. Beyond helping the board design an effective dispute resolution strategy and related policies, independent third parties or dispute resolution experts can help prevent or dissipate disputes by facilitating board discussions and retreats outside of standard board meetings.

An external, impartial dispute resolution expert can be especially desirable to mediate or help settle disputes between the board and external stakeholders. No matter how well-intentioned or objective a board director may be, it is unlikely that external stakeholders would fully trust that person, precisely because he or she is a board member and possibly part of the problem.

Helpful Documents

A number of the basic documents of a company can be used to install ADR processes and techniques.⁸ Some may not be appropriate to a particular corporation or business situation. All must be consistent with legal requirements of a particular country or jurisdiction under whose laws the corporation is created or in whose domain it is situated; therefore, they will be customized differently in different jurisdictions and for different kinds of business.

When drafting the documents that affect corporate governance, it is essential to this process to involve lawyers who understand governance issues, practices, and procedures and who, at the same time, are expert in corporate law matters. These professionals will be most expert in helping anticipate the types of governance disputes a particular company may be likely to face. Doing so guides the process of inserting ADR procedures and techniques early in the company's life. **Table 7.3** lists and describes company documents that may lend themselves to ADR installation.

⁸ This subsection is excerpted and adapted from an article by Alan Rudnick. It is copyrighted by Masters-Rudnick & Associates LLC, which has granted permission to IFC, its affiliates, and all who have completed the IFC training courses to reproduce all or part of this work on the condition that they provide proper attribution.

Table 7.3: Documents that Support ADR Installation

DOCUMENTATION THAT IS PART OF THE CREATION OF THE CORPORATION.	
Charter (called articles of incorporation in some jurisdictions) provisions	<p>The charter is the baseline corporate document. It creates the company’s basic economic structure, and it incorporates matters that are at the core of the corporate enterprise and provide protection for shareholder investments. If appropriate, the charter can contain provisions requiring mediation or arbitration. Depending on the law of the jurisdiction of incorporation, charters can also contain provisions as to the particular jurisdictional law that will be applied to dispute resolution, as well as the site of any litigation against the company.</p> <p>CAVEAT: Typically, charter provisions can only be changed by shareholder vote. Once a provision is in the charter, it is very difficult to amend it. Cautious lawyers often keep charter provisions to a minimum to ensure board flexibility as the enterprise develops.</p>
Bylaws	<p>Bylaws contain governance requirements that the board of directors itself determines. Bylaws can be changed by the board. They provide another place where binding procedures to be used in the event of a dispute are spelled out.</p> <p>Articles of incorporation can be drawn to permit shareholders to also change the bylaws; so while shareholder approval may not be required for a bylaw, shareholders can retain the right to do so. In some jurisdictions, the company law may give shareholders the right to make bylaw changes.</p>
Shareholder Agreements	<p>Often, the documents that create the corporation are accompanied by a separate agreement among shareholders. If the potential for dispute is high among various investors, a shareholder agreement can be a potent tool. It can also provide a useful procedural roadmap that makes clear for all disputants how matters will be resolved.</p>
GOVERNANCE DOCUMENTS THAT CAN HELP AVOID DISPUTES OR PROVIDE A PROCESS FOR RESOLVING THEM	
Statement of Corporate Governance Principles	<p>This document lays out governance principles and practices that apply to the company’s board of directors. It can easily include provisions regarding procedures to be taken when disputes arise. Debate and discussion is a positive attribute of a board. These debates typically are resolved through a vote. However, when differences of opinion continue, whether among directors, officers, or shareholders, this document can articulate the tone that disputes are to take, as well as how they are to be handled.</p>
Statement of Directors’ Responsibilities	<p>It is important and very helpful to articulate in advance exactly what duties directors have and what responsibilities each director is expected fulfill. This document, which can also be incorporated as part of the Statement of Corporate Governance Principles, can help set the tone for director conduct, including handling differences of opinion as they arise. This document should be shown to all prospective directors so they understand in advance what is expected of them and that their joining the board means they have agreed to its provisions.</p>
Committee Charters	<p>Committee charters articulate each committee’s jurisdiction and the specific responsibilities it must carry out during the course of a year. Questions of committee jurisdiction—such as which committee considers and decides certain issues—can be contentious. Charters remove uncertainty from this process.</p>
Board of Director Manuals	<p>Every board should have a manual that 1) pulls together all relevant governance documents, 2) spells out various company policies, and 3) answers practical questions that may arise for corporate directors, including questions about compensation and benefits. These manuals do not themselves resolve disputes, but they are quick-reference guides for what to do when matters become contentious. There is no reason why they cannot also include procedures for handling disputes. Along with the Statement of Directors’ Responsibilities, they should be shown to people before they join the board, and it should be made clear that their joining the board involves an agreement to the contents of the manual.</p>
Code of Conduct	<p>Every corporation should have a written code of conduct that articulates the ethical and operational culture of the company and its operating values. The code of conduct can include a provision that facilitates the resolution of disputes.</p>



2121 Pennsylvania Avenue, NW
Washington, DC 20433 USA
Tel: +1 (202) 458 8097
cgsecretariat@ifc.org
www.ifc.org/corporategovernance

