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Corporate Governance in the post-pandemic world

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Toward Value - Creating Governance®

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Human beings are wonderful amnesiacs, an observation grounded in the history of traumatic events which have faded gradually into oblivion. That may well be the case with the current pandemic.

For instance, how did societies, corporations and their governance system cope with recent dramatic events (so called "Black Swans" or for the more statistically inclined "Six-Sigmas" events, although many would rightfully question whether these were really "Black Swans")?

Take the financial/economic crisis of 2007-2008. Few sequels remain. Regulations of the financial sector were enhanced somewhat, banks had to increase their capital, executive compensation was "subjected" to an advisory "say-on-pay" vote by shareholders and some of the most outrageous financial speculations were curtailed. But overall, not much has changed despite the panic and dread at the time when many knowledgeable observers and actors feared a total collapse of the world's financial and economic system.

But 9/11 is a different story. Although located in New York, the event has brought about lasting, dramatic changes on an international scale. Air travel was never the same after 9/11. States and government have increased *permanently* their authority and means to surveil and control societies and the worldwide flow of communications. Some individual freedoms were sacrificed on the altar of security with the consent (?) of the citizenry.

As the current pandemic has a much broader and deeper impact, the 9/11 scenario offers a weak template for what will happen when the pandemic begins to fade away: greater control on citizens' behavior, close monitoring of all movements through instant communications, government-issued safe-conducts to gain access to any public event. Constitutionally protected individual freedoms will be infringed upon by a State/medical bureaucracy determined to protect us at all costs. All of these coercive measures will be promoted, and accepted, as essential to avoid a recurrence of some form of pandemic.

This painful experience will also foster some changes of a social/political nature: the work arrangements adopted during the crisis will call for a critical re-thinking of the standard pattern of commuting/office work/in-person meetings with colleagues. The resulting reduction of "polluting travel" will be hailed by all environmentalists despite the "irrelevant" cost of anomie, social isolation and estrangement.

The inevitable quest for greater self-sufficiency in many areas (food, pharmaceuticals, etc.) will bring about different industrial policies as well as a renewed skepticism about "globalization" and its supposed benefits.

But this latest crisis may also generate a lasting anxiety and a sense of vulnerability in large segments of the population, who will subject all their public activities to the imperatives of total safety.

The role and responsibility of boards of directors

1. Coping with uncertainty

Even if 9/11 or the 2008 financial crisis may not fully qualify as Black Swans, for most corporations these events were unexpected and unplanned for. Corporations were taken by surprise and had to improvise some response. After the 2008 financial crisis particularly, most boards have enhanced their role in risk monitoring and risk mitigation.

But, boards have to cope with *uncertainty*, not only risk. Uncertainty is different from risk because there is no probability estimate of the occurrence of uncertain event within a given time frame, no way to predict the likely occurrence of a "six-sigma" event. The typical "predict-and-prepare" approach of risk management system and process does not work.

There are always "clairvoyants" who claim, with some justification, that they had foreseen the catastrophe. But how often had they been wrong in the past?

So what is a board to do? To ask management to list all unlikely dramatic events to which a corporation may be vulnerable and prepare contingency plans for each would paralyze any organization. A bank executive claimed recently that his institution had planned for "all" contingencies (nuclear attacks, fires, hurricanes) but had never foreseen a pandemic (Richard Dufour, ***La Presse***, April 25th 2020). What about tsunamis, 9.0 earthquakes, an asteroid hit, etc.?

In an uncertain world where *unpredictable* and *uncontrollable* events may have catastrophic consequences, a board of directors must call upon management to ***hoard*** strategic and *financial* resources, build ***redundancy,*** and increase the corporation's ***flexibility and adaptability*** to uncertain events. (See Allaire and Firsirotu, *Coping with Strategic Uncertainty*, ***Sloan Management Review***)

Coping with uncertainty means:

• maintaining an acute sense of the firm's vulnerability;

• experiencing the future as largely unknowable; and

• considering the firm's survival to be dependent on organizational flexibility, on building buffers and redundancy and on hoarding strategic and financial resources.

No doubt such measures will have a short-term impact on earnings per share, on return on assets, on optimal capital structure. But that is the cost of some preparedness to cope with uncertain events.

2. Designing the organization for a new set of circumstances

There will be a decisive relaxation, even rejection, of the neo-liberal framework which has defined the functioning of societies and large corporations for decades: the expectation of continuous growth in earnings per share; the cost-driven global search for the locations of cheapest labor where to farm out operations; the massive creation of income and wealth inequality; the indecent enrichment from financial speculation and legerdemain, from activities with little or no social value; the trade-offs between debt, deficits and social expenditures with the former having a distinct priority over the latter.

Boards of directors should heed the early warnings of impending disturbances of a political and social nature. They may be harbingers of the next flock of black swans. If boards do not effectively handle expectations, they should expect governments, now flush with power, to take actions about work arrangements, executive compensation, sharing of wealth, punitive taxation for outsourcing, and so forth.

Contrary to what one might have expected given the serious financial issues that will be faced by many business corporations, the recent infatuation of large institutional shareholders with ESG (Environment, Society, Governance) drivers and its corollary, the stakeholder model of the corporation, will not abate. Too much wind in those sails and the pandemic will push further for compliance by publicly traded corporations.

It behooves management and boards of directors to act pre-emptively in five areas:

- Monitor and enhance the corporation's self-sufficiency in critical supplies within the home country;
- Review and re-assess all past decisions to outsource and off-shore operations to low-cost countries;
- Design work arrangements to adapt to the circumstances post pandemic as well as to the people's legitimate quest for balance, couple burden sharing;
- Cut the Gordian Knot of executive compensation; examine the form and level of compensation so as to reduce the gap and set an acceptable ratio of top management compensation to the salary of the median employee;
- As most large institutional funds have become advocates of ESG, make clear to shareholders what this emphasis and the above adjustments will mean for the management and performance of the company in the future.

The powerful forces of continuity, habits, and normalcy may bring us back to the *status quo ante.* We may wake up from this nightmare unscathed. Perhaps! But a board of directors should not take this happy ending for granted.

The authors are solely responsible for the opinions expressed in this article.