**SEVEN LESSONS FROM 'THE PERFECT PREY'**
**ON IMPROVING THE FUNCTIONING OF EXECUTIVE AND SUPERVISORY BOARDS**

**By Peter Idenburg and Rob Mommers** [1]

*One of the oldest puzzles of politics is who is to regulate the regulators. But an equally baffling problem, which has never received the attention it deserves, is who is to make wise those who are required to have wisdom.*

J.K. Galbraith, The Great Crash

*This article takes the case of ABN·AMRO to formulate general lessons about the functioning of executive and supervisory boards in organizations.*[2,3]

## Introduction

In October 2007, the Dutch national pride ABN·AMRO was sold to an international consortium of three banks. The consequences of this 72 billion euro takeover were dramatic. The lead acquisitor, Fortis, went virtually bankrupt one year after the takeover. When the financial crisis struck, the Dutch government had to take control of all of ABN·AMRO's operations in The Netherlands. The Royal Bank of Scotland had to be

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[2] The Dutch corporate governance is based on the so-called two tier system, with two separate boards, a supervisory board with supervisors or non executive directors and an executive board with executive board members, presided by the chairman of the executive board or CEO. In this article "The Chairman" refers to the chairman of the supervisory board. The lessons in this article are applicable mutatis mutandis to non executives and executives in different profit and not-for-profit governance regimes.

[3] The original 2009 article was translated from Dutch and adapted for international readers in April of 2010.

rescued by the British government. Only Banco Santander turned out to be sustainable.

Jeroen Smits' book 'The Perfect Prey' investigates the history and the conditions that led to the acquisition of ABN·AMRO. It is a product of excellent journalism, giving a unique insight into the functioning of the executive board of ABN·AMRO and the interaction between that board and its supervisory board. After its release in October 2008, the book became an instant bestseller. Many commentators and editorial articles referred to its revealing contents. Wouter Bos, then minister of Finance, called on all of his civil servants to read the book.

Several years after, various questions that arise from reading the book are still relevant. Was the situation at ABN·AMRO unique or do the executive and supervisory boards of other companies function in a similar manner? Which general lessons about management and supervision can be drawn from this drama? Is a renewal of the supervisory function called for?

We set out to answer these questions and spoke about these issues with ABN·AMRO insiders who shared their thoughts openly on condition of anonymity. This article distills seven major lessons from these conversations. It is neither intended as a critical review of 'The Perfect Prey' or an evaluation or final judgment of the chief protagonists in this history.

Nearly everyone we spoke to agrees that the exercise of the supervisory function within the bank fell short,[4] and that it might have been prevented that ABN·AMRO was sold to the international consortium. The opinion that supervisory boards should change and function differently is also broadly shared. This conclusion concerns all companies and not-for-profit organizations.

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[4] External supervisory authorities such as De Nederlandsche Bank (DNB) also influenced the conditions that led to the takeover of ABNAMRO, but this article does not concern them.

It is easy to draw superficial conclusions after reading 'The Perfect Prey'. One such conclusion is that the entire Corporate governance legislation for supervision should be overhauled.[5] Another is that it was blind pride or Machiavellian practice in the board of directors that led to ABN·AMRO's demise. For an alternative, real understanding, we should take into account a complex situation involving many factors and actors and evolving over a period of more than 15 years.

The authors of this article are of the opinion that there must be rules and regulations. However, if the operations of executive and non executive board members are completely pinned down by rules, this will lead to behavior exclusively concerned with compliance and consequently lead to the erosion of private responsible conduct of the members.

No matter how many rules, the real test for non executives remains how to discharge their tasks in actual practice, how to make use of their prerogatives and how to fulfill their moral values. Supervision is a job with rules of conduct. It is based on sharp observation, knowledge, insight, wisdom and intuition. Enforced rules never satisfy as means to anchor moral conduct and values.

Supervisors and executives at ABN·AMRO belonged to the top brass of Dutch and international business. Better supervisory directors cannot be found. The lessons from 'The Perfect Prey' should be found in better teamwork by supervisors and between supervisors and executives. Human behavior is at stake here, not abstract systems or a choice between *one tier* and *two tier* boards.

*The most important conclusion – the one that connects the following seven lessons from 'The Perfect Prey' – is that supervisory boards and executive boards must become better in teamwork.*

[5] This article does not refer to new rules for banking activities after the crisis.

## 1. A culture of indecision

*Supervisors must secure that the executive board makes choices when circumstances demand so. Postponing or not making choices in order to avoid pain or other problems is also a choice, which will backfire sooner or later.*

The merger of the ABN and AMRO banks in 1991 was a joining of forces on the basis of equivalence. Not only were the names of the constituting parties merged, but also the entire executive and supervisory boards of both banks. The architects of this merger, Hazelhoff (ABN) and Nelissen (AMRO), decided to cover up any differences and to avoid conflicts of the kind we saw later when, for instance, Pakhoed and Van Ommeren merged to become Vopak. It is possible that the merger talks would not have succeeded if from the outset choices had been made about the future direction of the bank and about cutting the number of executive and supervisory directors. However, by not dealing with these issues immediately, a major flaw of the merger product remained. This flaw would confine all parties within the bank, until the acquisition of ABN·AMRO in 2007. The culture of the merged bank became not to make choices.

Under the presidency of Jan Kalff (1994-2000), the bank saw a period of virtually unlimited growth, essentially without any restraining (financial) framework. Big acquisition projects in the USA, Brazil and Belgium kept the top managers busy (even though the latter failed).

At the start of the third millennium, a turning point became clear. The returns were too low, there was a shortage of capital and the development of the bank came to a standstill. The Enron affair and 9/11 triggered developments that resulted in strong external limitations to ABN·AMRO's growth. Specifically, the Sarbanes Oxley Act and the newly strengthened supervision practice in the United States curtailed development.

In 2000, Rijkman Groenink became CEO and formulated new goals that had to turn the bank into an international top player. At that time, long present problems became more urgent. The bank turned out to be *stuck in the middle:* unable to compete with the world's biggest in either retail or investment banking. When it became clear that Groenink's new goals could not be achieved, he proposed to reassess them, believing that it would be better to correct the bank's ambitions than to fail altogether. However, this reassessment was considered wayward policy. Groenink failed to obtain the  supervisory board's support; official ambitions remained unrealistically high.

In 2005, the bank started a new acquisition project of Antonveneta in Italy. This long but ultimately successful acquisition diverted attention from the emerging cliques with divided loyalties within the executive board. The culture of indecision grew to have a near stranglehold on the functioning of the executives, but they were incapable of solving these issues and the supervisory board did not urge them to make or implement fundamental choices or did not see the urgency of doing so.

The cultures of the retail and investment bank –  the type of banker, the success factors and the remuneration – differ so strongly that in fact no examples exist of banks were these activities are successfully integrated as equals. The board of such a Mesopotamia can function only as the holding company of a portfolio of activities. In practice, the board members do not share a sense of collective responsibility for the overall result of the company, even though, according to the officially chosen legal formula, they should. Instead, board members trade favors and consider themselves as guardians of the interests of the business unit managers that report to them – managers that are fighting for their own turf below the board level. These managers do not circulate between business units but remain dedicated to one activity during their entire career.

Ever since the merger, a lot of time and effort was wasted discussing and deciding on a shared vision for the future development of ABN·AMRO. When a principal choice for that development was eventually made in 2001, the implementation was frustrated by the remaining, underlying oppositions.

Sooner or later, every diversified company must decide what constitutes the added value of its interlinkages. This added value must be proactively and decisively pursued, *before* external factors demand so.

## 2. Focus on core activities

*Fully understanding the core activities and nurturing the core competences of a company are key success factors.*

Since C.K. Prahalad and Gary Hamel introduced the concepts of *core activity* and *core competence* in their 1990 HBR article *The Core Competence of the Corporation*, these have become generally accepted business principles. The quality of the core competences results from training, attention and energy of people, the coherence and interaction between employees and investments. For the oil exploration, production and refining activities of Shell, the core competence is processes and process management. For Unilever, it is products and marketing. For a retail bank, it is client services. But for an investment bank, it is the dealmaker, who is singularly focused on realizing transactions.

Due to the dominating pursuit of shareholder value, the executive board of ABN·AMRO became the manager of a portfolio of business activities. The definition of what constituted a core competence could be changed at a glance if that would promise a higher return. As a consequence, the bank gradually lost sight of its core activities and the corresponding core competences. At one point, ABN·AMRO in The Netherlands declared a large group of its employees 'superfluous'. The bank turned away smaller corporate clients because they yielded too little profit. The promotion of rich clients to become 'preferred clients' suggested to other clients that they were second class citizens.

In the 1990's and the Kalff period, credit analysis was still considered the core competence. In the traditional style of grandmothers kitchen, individual credit lines received all due attention. After Groenink became CEO, these activities disappeared from the board agenda.

In any investment bank, the best dealmaker is boss. He knows his value and the quality of his client relationships.  In fact, the dealmakers themselves are the product. The importance of completing the transaction, with the attached commission, is their primary orientation.

The pursuit of shareholder value as the sole criterion for measuring the results of a company is simply unsustainable. In such a company, an indirect result becomes the main purpose. In fact, shareholder value is a product derived from many components, including the realization of value in the core activities. Supervisors and executives of an integrated company must understand the core activities, must decide on the success criteria and track their development with due care and attention. An example where this focus disappeared entirely is VNU Publishers, which in the course of the years went through such a radical transformation that hardly any of the original core competences and the related people survived.

### 3. Teamwork

*An executive board must invest in a genuine dialogue to achieve consensus and must draw clear conclusions from dissident behavior or not following up on commitments.*

'The  Perfect Prey' gives a detailed account of the culture of teamwork inside the executive board, providing interesting insight into patterns, rules of behavior and the leadership culture in the bank. Confronted with these insights, questions about the quality of teamwork arise. What are the dynamics between the executive board members and how are decisions made? Do the executives act like colleagues and do they accept a joint responsibility for the entire company or do they act as proxies for the business activities under their direct responsibility? Are they ready and willing to engage in a real dialogue with the aim of achieving consensus, or at least broadly supported decisions?  Or is the board only a platform for the exchange of information, with the tacit assumption of non-intervention by other board members, in order to avoid conflicts? In the last case, the board is playing cat-and-mouse, a game in which nobody is entirely safe. To keep the board functioning in these circumstances, the 'demining services' must come and clear the area from time to time, in the form of an external coach or the chairman of the supervisory board.

At ABN·AMRO, the executive board members behaved as if they had split personalities. They supported their board decisions verbally, but their actual managerial behavior in relation to the concrete policies showed the opposite – a lack of support. Their opinions depended on whom they were speaking to; this is learned instead of authentic behavior.

The merged bank did not have a tradition of strong leadership. The CEO could stop decisions which he disliked and the executives were entitled to veto decisions about their domains. This resulted in the formation of cliques, passive resistance, fake consensus and lip service : saying 'yes' and doing 'no' or the inverse. To take an example from soccer: eventually, it does not matter whether a team plays in a 4-2-4 system or a 4-3-3 system, as long as everyone acts his part. If this basic discipline is absent, the entire organization needs to deal with the far reaching consequences. This has much to do with exemplary behavior, which resonates in all levels of a business.

Rijkman Groenink was locked inside the board system and was unable to free himself. If a CEO does not act when commitments are not fulfilled, anarchy follows. Because nobody was taking any fundamental decisions, members of the executive board were no longer really involved, they lost their inspiration and backed out. The CEO is responsible for achieving real consensus and should intervene if that consensus is a fake. A deal is a deal. One is part of the game or one should take the consequences. You either play by the rules of that game, or should not play at all.

If a member of the board does not observe these basic rules there are really only two solutions: either the dissenter leaves the board of executives, or the CEO is replaced.

## 4. Passively observing / Actively supervising

*Supervisory directors must invest in themselves and in their team's development. This represents the difference between being a passive observer and an active supervisor; the difference between just looking on and contributing to the continuity of the company.*

The task of the supervisory board goes way beyond functions that are required by law or regulatory codes; it goes beyond approvals and appointments. Supervision in business also means: making agreements and commitments and controlling their follow-up, setting limits, demonstrating authority, guarding integrity and applying corrections via warning signals, clear instructions and – when all these fail – discharge of certain responsibilities or dismissal of executives.

A supervisory director should understand the context of the company and be aware of the role and broad, social responsibility of the board. He or she should be independent not only in a legal sense, but also in social and moral standards, attitude, opinion and posture. When properly mixed, these ingredients represent integrity.

Working from this basic integrity, supervisors must be critical, demand justification, but should not be overly controlling and give their confidence to the executives until clear signals demand otherwise. A supervisor should be informed and experienced; able to get all the relevant facts on the table, to question the executives and to break through intransparancies in their information. Supervisors should understand why executives want certain things, what drives them, how the emotional dynamics in the board play out. Summing up, supervisors should do all those things that put them in a position of shared responsibility for the behavior of the company.

The supervisory board of ABN·AMRO did not act when the strategic dilemmas and disagreements within the executive board were not solved. Under the eyes of the supervisors, the leadership and management culture in the bank produced deadlock situations. Even when the CEO presented his dilemmas, the supervisory directors did not really lend him their ear. No solution was enforced.

The disagreement and disconnect inside the executive board impacted the supervisory board too. This was a very traditional supervisory board, basically passive, without taking action and responsibility. Supervisory directors usually have a very rich knowledge and corporate experience. They believe they know everything. But a supervisory board should invest in loyalty and respect, and in its own development as a team – even though they meet only 6 to 8 times a year. Just being competent as a supervisor – being a controller instead of an ambassador – is not enough. There needs to be a team effort.

Increasingly, this team building effort happens in *off-sites* with external facilitators. Those who are keen to collect supervisory board positions, but have no time or energy for these meetings, are unfit. Executives also carry a responsibility: they too reap the benefits from a well functioning supervisory board that refuses to act as a rubber stamp.

## 5. The chairman of the supervisory board

*Within the supervisory board, the chairman plays the lead role. He should be genuinely independent of the CEO and act as an architect and director of the processes within his board.*

The chairman of the supervisory board is the linking pin between supervisors and executives. He is the decisive element in making or breaking the successful cooperation between the two boards. The chairman is responsible for the team development which mobilizes his own board's potential. Under the chairman's guidance, the team can grow, change and transform. The dynamics within the supervisory board, moreover, set an example which can influence the interaction patterns between executives.

There must be a relationship of fundamental trust between the chairman of the board and the executives. The position of a CEO who is not supported by his chairman is extremely vulnerable. When there is no basis of fundamental trust, the executive board members will stay silent as children do when their parents are angry. On the other hand, the chairman should maintain a posture of independence towards the CEO and should have one-on-one meetings with the other executives at least once a year. He must supervise the CEO and avoid that a *folie a deux* emerges.

To be truly independent, the chairman should not be afraid that success or failure of the CEO affects his own reputation. If there are struggles between executives which they themselves are unable to solve, the chairman should seek compromises or take decisive action. 'The Perfect Prey' describes various occasions where chairman Loudon did not support proposals by CEO Groenink without proposing alternative solutions. This attitude contributed to the erosion of Groenink's stature as CEO.

The chairman is supposed to engage actively with the company. He must give the executives leeway, but he should also be an attentive listener and should not be overly dominant. He is the guardian of the respect of supervisors for the executives and should prevent that the latter feel treated as freshmen, as some observes of the ABN·AMRO board meetings reported. The board meetings should not degrade into meetings with pro forma agendas, in which everyone is asked for his/her opinion in turn, and the chairman subsequently concludes what the meeting has decided. In such a setting, there is no time and space reserved for further discussion about divergent opinions or for a more profound discussion on key issues.

When the American Arthur Martinez became chairman in a very turbulent time, it became evident that the chairman should ideally have residence not too far away from the head office and have close affinity with the culture of the country where the head office is located. Otherwise, the geographical and cultural distance simply becomes too big. This will detrimentally affect the functioning of the board.

## 6. Fair Process

*It is only on the basis of fair process that a board can be forged to become a unified team, with members feeling jointly responsible. If a director feels he is not really seen or heard, he has two options: disconnecting or stepping down.*

Real commitment of people not only depends on the outcome, but also on the process of exchange of opinions which leads to a decision. For the successful operation of a board, content and process are of equal relevance. Fair process in the boardroom is of decisive importance for the successful interplay between supervisors and executives. The members want to have their say, want to be heard and be convinced that their opinions have been taken into account, even though the final decision may be different.

In particular, the nomination process and appointment of the chairman and members of the executive board should be systematic, correct and guarded with extreme care. An important part of fair process is that the chairman explains why a certain decision has been taken, which arguments pro and con were taken into account and that he ensures that there is clarity about the consequences of a decision and about the rules of the game which ensue.

Fair process also embodies a culture of diversity within the board and openness for dissident opinions and even encouragement to venture those on the basis of (implicit) equivalence and mutual respect. In any real dialogue, the outcome is uncertain. This is the essential difference with a discussion, which always comprises non-negotiable elements. Only on the basis of an open dialogue can blind spots be uncovered and *groupthink* avoided. Fair process of board operations is the opposite of a board with a predetermined agenda and an explicit or tacit hierarchy. It also differs substantially from a board culture where members behave as proxies of their supporting units. Only on the basis of fair process can a board really be forged to unity, with members feeling jointly responsible.

## 7. Evaluation and self-evaluation

*Processes of evaluation and self-evaluation of supervisory and executive boards should be addressed more systematically. Assessment of proposed members to chart the consequences of their appointment on the functioning of the team is desirable.*

The Dutch corporate governance code prescribes that at least once a year, the supervisory board, in the absence of the executive board members, discusses the functioning of the board as a team and of the individual members, as well as its own functioning and that of their members individually. In many a boardroom, this evaluation and self-evaluation is still in its infancy. At ABN·AMRO, supervisory directors operated at a distance, with little time available. They left it to the CEO to orchestrate their exchange with executives in board meetings. Outside these meetings they had few contacts with individual board members, let alone with managers one level down.

Contacts of individual supervisory board members with executives must take place in an orderly way. Due diligence and care applied to hearing individual executives will influence their behavior as team members.

The evaluation of executives must also take into account who they are as human beings, not only what their formal capabilities or results are. How do they behave in and outside meetings? Do they behave differently in their private lives? How do they operate within a team? Do they consistently operate on the fringes of what is acceptable, keeping one another captive of their own ambitions? An assessment prior to the appointment of executives may provide clues about their possible influence on the functioning of the team. Narcissistic behavior of CEOs or executives will sooner or later harm the company dramatically.

The self-evaluation of the supervisory board is an important moment for reflection on their own behavior and that of the board as a team. In this context, the exchange of feedback must be stimulated. The chairman must play a leading role, possibly supported by an external adviser. Executive sessions and *off sites* provide reflective space for this purpose.

It is incredibly difficult to behave independently from the other members of the supervisory board. The board must withstand the pressure from the executives and remain loyal to their own principles, even when the executive board seeks uncompromising support in difficult times. The self-evaluation of the board should be preceded by an external evaluation by an independent third party at least once every three year. In these talks, all supervisory board members and possibly also executives should be heard.

These seven lessons from 'The Perfect Prey' illustrate that knowledge of rules and regulations is *not* decisive for the improvement of the supervisory function. Instead, it all boils down to (team) behavior, morality and feeling. Only on the basis of these qualities can supervisory board members confidently respond to the poet Albert Verwey's call and encouragement painted in golden letters below the tower clock of Berlage's  Exchange in Amsterdam: *Beidt uw Tijd en Duur uw Uur* (Don't waste your day and know your time.)

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