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Snakes who charm...

***Anthony Fitzsimmons** uses financial scandals to illustrate why company boards need to keep a watchful eye on charismatic or domineering chief executives*

Bent, bullying, domineering or hubristic, toxic leaders are often charming when it suits them. No competent board should harbour one.

Charles Ponzi was a confirmed crook before he began making money from currency arbitrage. He earned 14 years behind bars and immortalisation – even the well-intentioned pay-as-you-go UK state pension system has been called a "Ponzi scheme". Bernard Madoff followed in Ponzi's footsteps. But both were effectively loners without boards to keep them in check.

Dazzling Bright

Michael Bright and Philip Condon developed a team that ran what became Independent Insurance. Charismatic, fun-loving Bright became chief executive and Condon his deputy. The business floated in 1993 and became a leading liability insurer. By December 2000, the share price had risen eightfold. Bright was named as the *Financial Times's* Business Entrepreneur of 1996 and president of the Chartered Insurance Institute in 2000.

But the business was rotten. Late in the 1990s, Bright and his finance director, Dennis Lomas, realised that liability claims would cost much more than they had reserved. Progressively cooking the books, they were soon hiding claims of more than £100m, undervaluing large losses and hiding documentation from actuaries and accountants. They even bought a reinsurance contract designed to camouflage the hole.

They confessed to their chairman in 2001. Bright resigned and Independent collapsed. Bright, Lomas and Condon were convicted of conspiracy to defraud and locked up. The judge described Bright as an overbearing bully. The auditors and the actuaries were sued and settled confidentially.

For years, rumours had rumbled around the insurance market that Independent was too good to be true. A friend of mine's board asked why their liability insurance results lagged behind Independent's. He told them that Independent must be cooking its books. Months before the crisis emerged, another friend and I analysed its published accounts and insurance returns. We discovered the hole, its scale, the reinsurance and how it was being misused to hide the hole. Yet the board of Independent directors had no idea what was going on under its noses.

Why? Bright's board failed to deal with the risks that went with his character. Seemingly unaware that Independent was defying market profitability trends, and of the market gossip, the board failed to question whether the company's apparent outstanding success was genuine or illusory.

Board ignorance may have tempted Bright to fudge the figures

I could find no evidence that the board had real experience of liability insurance; yet almost the first thing I had learned as an insurance market novice was how easily, and often, liability claims figures were "improved" by distortion and worse. Board ignorance may have tempted Bright to make his first fudge of the figures. Unable to spot his dishonesty and, perhaps fooled by his charm, Bright's board provided the environment in which he could, and did, turn to fraud.

Fred the Shred

Fred Goodwin arrived at Touche Ross in 1979. According to the author Ian Fraser, whose minutely researched *Shredded: inside RBS, the bank that broke Britain* is my source, Goodwin "impressed" John Connolly, then UK managing partner, who "ensured he became their youngest-ever partner". He was one of the team working on the Bank of Credit and Commerce

International liquidation, although he later claimed to have led it. Years later, having advised National Australia Bank on its acquisition of a clutch of banks that included Clydesdale, he became Clydesdale's chief executive. There, Fraser says, he shocked staff by his micromanagement and apparent "delight in tearing strips off colleagues and 'shredding' them in front of their colleagues".

George Mathewson, Royal Bank of Scotland's chief executive, was impressed by the charming, intelligent side to Goodwin he met at a market committee. Looking for a new chief financial officier, Mathewson wooed Goodwin, who insisted on becoming Mathewson's designated successor. Mathewson eventually agreed, and Goodwin arrived, as chief financial officer and deputy chief executive, in 1998.

Within weeks, Goodwin was, former colleagues told Fraser, being "deliberately confrontational" – although charming when it suited him. He developed the habit of "eviscerate[ing] senior colleagues at daily morning meetings, leaving people afraid to speak up". Mathewson had previously been trenchant that people who bullied subordinates but were sycophants to superiors were bad for business and should be rooted out, but this seemed not to apply to his "protégé".

Following the NatWest takeover in 2000, Goodwin became chief executive of RBS in 2001. Mathewson became deputy chairman, rising to chairman. Some thought Mathewson understood Goodwin's nature and could control him. That is not what happened.

Fraser reports that weeks before becoming chief executive, Goodwin had a "contretemps" with PwC's audit partner, (now Sir) Amyas Morse, who apparently would not approve Goodwin's preferred "racy" accounting treatment of the NatWest acquisition for the 2000 accounts. According to Fraser, Goodwin, as the new chief executive, "unilaterally fired" PwC a few weeks later and, "without a tender", "appointed" his old firm, by then Deloitte, led by his former mentor Connolly – only seeking Audit Committee approval afterwards. Goodwin is also said to have become involved in selecting the non-executive directors (Neds) whose role was to challenge him and to have manipulated the board to minimise opportunities for challenge. If Fraser's narrative is right, board-level alarm bells should have been ringing loudly.

At a 2001 executive conference, senior executives apparently summoned up the courage to tell Goodwin that the culture of fear pervading the bank was their top issue. He reportedly responded: "Don't tell me you're frightened of little old me?" RBS was primed for trouble.

Boards and their role

Appointing a new chief executive is one of the board's most important tasks. We are all a blend of character traits. Good boards understand that, while competencies determine what chief executives can do, character, together with their environment, strongly influence what they will do.

Chief executive traits such as drive, enthusiasm, self-confidence and charisma are attractive but double-edged. Only boards can manage the risks they bring. Our research suggests that few boards display the necessary skills. Surveying half the FTSE 100, we found that only 3 per cent of Neds professed a relevant background, such as education in areas including social sciences and psychology or human resources. It takes skill, knowledge and experience to analyse and understand character and its implications. We need self-awareness and effort to overcome cognitive biases such as the self-serving bias, loss aversion and overconfidence, which readily blind us to weaknesses in those we have chosen. Neds who can see problems also need the character, and especially the courage, to overcome the pressures from social silences, social norms and incentives that discourage them from challenging a "strong" chief executive.

> *Few boards have the skills to understand and challenge their chief executive*

Had the RBS board understood and managed the risks inherent in Goodwin's character and provided the robust challenge he needed, the bank's story would have been different. Goodwin would have been brought under control or sacked long before 2007. RBS would most likely not have failed. And the UK's national debt mountain would have been tens of billions of pounds smaller.

Any chief executive who turns out to be a snake deserves disgrace. But Neds should have the skill, knowledge, experience and spine to understand, support and challenge their chief executive. Those who fail to do so deserve as much opprobrium as any viper they nurture. ■

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