

# Governance weaknesses can place billions of dollars at risk

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**A few months ago, I made the case that good governance, which includes transparency, is foundational to improving valuations. This month, I offer a glimpse of such an improvement, starting with a tragedy.**

On the 29<sup>th</sup> October 2018, Lion Air Flight 610 departed Jakarta for Penang, carrying 189 passengers and crew. As you probably remember, it never reached its destination. The plane crashed and everyone died. The plane was a now-infamous Boeing 737 MAX.

Following the crash, a debate began about possible design flaws in the plane, but no action was taken. On the 10<sup>th</sup> March 2019, an Ethiopian Air flight, also a Boeing 737 MAX, crashed, again with no survivors.

Within days, the entire fleet of 737 MAX planes was grounded. After more than a year, the planes remain grounded.

Key executives are no longer with Boeing. The company's reputation took a severe hit.

From a valuation perspective, the various aspects of these tragedies have cost around US\$50 billion in market value.

What, if anything, could have been done prior to the crashes to identify the risk?

Let me be clear. There was not enough public information to predict the specific problems that subsequently were revealed.

However, we can gain some perspective on risks that were not captured in the pre-tragedy valuation of the company. This insight was available through public information available prior to the first crash.

Anyone using the insight could have concluded that there was downside risk not reflected in the valuations.

Magni, the firm I lead, measures corporate governance. We believe governance is revealed through the behavior of the people in the company. By assessing behavior, we can measure the degree of good governance.

Magni refreshes company governance assessments every couple of years.

Serendipity may be at play as Magni completed refreshing Boeing on the 3<sup>rd</sup> October 2018, a few weeks before the first crash.

At that time, Boeing received a below-average score, though one that was not terrible. The score indicated that other companies were better governed, though the score did not, by itself, provide much insight into risks.

That said, looking at the scores on individual factors does provide insight about risk.

Boeing received high scores for managing its shareholder relationships.

Basically, it was good at managing with the objective of maximizing shareholder value per the traditional definition of the purpose of a company.

The scores for supplier relationships and competitive interaction were acceptable, with no major concerns; however, the scores for customer, employee and community relationships indicated weak governance in specific areas.

The company had weaknesses in listening to both its customers and its employees. The leadership also had weaknesses in establishing and managing a culture and environment where complex decisions needed to be made.

From a community perspective, the company did a lot of 'giving back' and attempted to be a good environmental citizen.

At the same time, it did not appear to be strong in working with government jurisdictions.

This combination of weaknesses may have caused Boeing's problems to be far worse than they might have been.

The weaknesses in listening probably kept the leadership from understanding that major problems were festering in the organization.

The culture and environment did not encourage principled decision-making or raising issues outside of reporting lines.

While the significant focus on 'giving back' and the environment is important, these efforts may have obscured the reality that Boeing was not being a responsible citizen with the very regulatory bodies that could help identify problems sooner.

As with many tragedies, bad decisions become worse when they are made in an opaque environment.

We will never know whether better or different governance at Boeing could have prevented the loss of so many lives.

What we can do is assess governance to identify risks that otherwise are unseen by the use of traditional methods. ☹️

