ERP Projects & The Board of Directors Duty of Care

We received a call concerning an organization that had failed miserably in its attempts to launch continuous improvement initiatives including the selection and implementation of a new ERP solution. The negative impact was felt in employee stress and turnover, customer service failures, engineering change management, supplier relationships and a loss of management controls. There was a significant impact on cash flow and earnings.

When we've seen this situation in the past, the mediation we undertake is typically between the organization and the ERP solution provider. In this case, our task was to assess whether the Board of Directors had executed their Duty of Care in authorizing and monitoring the projects.

Background Information

This Canadian-based organization has been in business for more than 40 years and has been quite profitable during its history. It employs ~350 people in two locations (Canada and the USA).

At a point in its history, the founder of the business decided to move towards retirement and decided to allow employees to purchase shares in the organization. To purchase shares, an employee has to work for the organization for a minimum of five years and have an good human resources record. An employee's shares were subject to the following conditions:

- Retirement: Sell back to the organization within five years of date of retirement.
- Resignation: Sell back to the organization within six months of resignation date.
- Involuntary termination: Organization pays out the last stated share price within 10 days of termination of employment.
- Voluntary sell-back to the organization.
- The purchase price is based on the value of the shares at the last financial quarter end.

As of the end of their last fiscal year, approximately 84% of the organization was owned by employees and retirees. The Board of Directors is comprised of the founder, one representative from the US division, one representative from the Canadian operations and two external members (one lawyer and one accountant).

The Situation

The retirees, and a few other employees, had seen the reduction in quarterly dividends being paid and started asking questions. As a result of those questions, and a review of the financials, the consensus was that the only significant factor that had impacted their quarterly earnings was the continuous improvement initiatives and, more specifically, the acquisition and implementation of the ERP solution. So the question became: “Who’s responsible for this?” Then followed the question: “Can we, the impacted shareholders, get compensation for this mess?”

One of the retirees has a friend who is a litigation lawyer, and they had a few drinks one evening. The good news is that they agreed that litigation would not be the best approach to solving the issue…at least, not yet. The approach they discussed was to have an independent analysis of how the situation evolved and what, if anything, could have been done to manage the risks better and reduce the amount of damage done. This was communicated to the rest of the interested parties and an investigative process was put in place. This is where Emercomm came in.

The Investigation

In the beginning…

- The Board of Directors (BoD) authorized the capital expenditure and resource plans for the projects.
- The President (no relation to the founder) of the organization was charged with reporting to the BoD monthly or if a critical issue requiring BoD review occurred.
- A Project Director (PD) was assigned.
    - The PD had no previous experience leading this type of project and lacked some useful skills, but was seen as a future executive.
- Teams were created.
- An independent consultant was contracted by the Project Director. That consultant was later interviewed by Emercomm as part of the investigation.
- Projects were launched including an ERP Selection Process.

As projects got under way…

- The BoD accepted at face value what the President presented.
- The President accepted what the Project Director was communicating.
- The PD *did not accept* the following recommendations of the independent contractor:

  - Create a proper Organization Change Management project within the other projects.
  - Educate the BoD and Senior Executives on various topics.
  - Educate the project teams on topics such as risk management, ERP concepts, quantitative process modeling and re-engineering, cross-functional impact analysis, etc.
  - Maintain a Single Point of Contact process for all communications to / from the ERP solution providers.
  - Document everything including capturing the ERP demonstrations on video.

As the projects continued…

- The BoD continued to accept what the President was communicating: The projects would be brought under control.
- The President started to question the PD's answers, but the politics of the situation had him holding back on going directly to the source of the problems.
- The PD figured that it was time to get out before they were terminated and left the organization mid-implementation.
  - Remember the recommendation regarding documentation? The only positive here is that many team members kept their own notes and documentation.

The Analysis

Both the BoD and President failed to exercise their roles properly as the projects got underway and continued to show negative results.

- The BoD did not investigate the situation properly nor contact the independent consultant.
- The President did not fully validate what the PD was communicating, did not contact the independent consultant and did not take appropriate action as multiple issues mounted.
- The ERP solution provider was able to convince several of the team members that their solution was the best without having to prove a full solution or commit to project timelines.

Duty of Care

The retirees, and other shareholders, are now looking at the responsibilities of the BoD and President under Section 122 of the *Canadian Business Corporations Act* (CBCA) which states:

- Directors and officers of Canadian companies have two main duties:

  - ***Fiduciary duty of loyalty:*** Directors and officers must "act honestly and in good faith with a view to the best interests of the corporation."
  - ***Duty of care:*** Directors and officers must *"exercise the care, diligence and skill that a reasonably prudent individual would exercise in comparable circumstances."*

The CBCA sets out the factors directors and officers should consider when acting with a view to the best interests of the corporation. These factors explicitly include consideration of interests beyond the shareholder, such as employees, consumers, the environment, and the long-term interests of the corporation.

Directors and officers can be personally liable for actions taken, or not taken, that do not comply with these requirements.

Going Forward

There is a new PD in place who has experience with the ERP solution in a similar industry. The organization has an offer letter out to a person that will fill the new position of Director of Change Management (DCM). The DCM is responsible for all continuous improvement initiatives and Organizational Change Management.

The PD and DCM will report jointly to the President and the BoD.

The ERP Project

After negotiations directly held with the ERP technology organization, their partner organization has been removed from the project and substantial concessions have been made to get the project completed in a timely manner.

Summary

How this situation is concluded with the BoD and former President is not the point of this article. We think that the take-aways of this article should be:

- BoD's have a responsibility, when authorizing these types of capital projects, to create a reporting structure that ensures that timely, accurate information is provided to them in order to minimize shareholder and stakeholder impacts.
  - The easiest method of doing so is to have an independent consultant report directly to both the CEO / President and the BoD.
- Put proper controls in place at all levels of the organization.
- Do not let unqualified people be the leaders of these projects.
- Organizational Change Management is a critical component to success.
- If you are a Director or Officer involved in organizations that are undertaking significant projects such as these, check with your insurance company to determine what your coverage includes.