Challenge at the heart of board effectiveness

This year, for the first time corporate governance turned to the field of social and human science for answers. Sir David Walker's Review of Banks and Other Financial Institutions was the first review of corporate governance to cite behaviour, culture and the 'softer' elements of business as critical factors to board performance and ultimately, business performance. His report published in November 2009 identified that 'serious deficiencies in prudential oversight and financial regulation in the period before the crisis were accompanied by major governance failures within banks, these contributed materially to excessive risk taking and to the breadth and depth of the crisis. The need is now to bring corporate governance issues closer to centre stage'. He went on further to say that whilst financial regulation can accomplish a lot, better governance, through better behaviour needed to be the primary focus. 'The behavioural changes that are needed are unlikely to be fostered by regulatory fiat.'

The Financial Reporting Counsel (FRC) in its review of the UK Corporate Governance framework, The Combined Code, also reported in July 2009, that 'there is a recognition that the quality of corporate governance ultimately depends on behaviour not process, with the result that there is a limit to the extent to which any regulatory framework can deliver good governance'. In May 2010, a revised Code was published, The UK Corporate Governance Code. In this a number of the recommendations about boardroom behaviour were extrapolated directly from Sir David Walker's Report as they were relevant to the broader business community of UK listed companies. There are three statements made in relation to the requirement of boards to 'comply or explain'; these directly relate to the chairman and board-directors role in promoting an effective dynamic in the boardroom.

1. The chairman should also promote a culture of openness and debate by facilitating the effective contribution of non-executive directors in particular ensuring constructive relations between executive and non-executive directors.

2. As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

3. Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes.

In addition, the Code was amended to say that to help enhance the board's performance and awareness of its strengths and weaknesses, it 'requires' that a board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. Furthermore, 'evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years'.

Evidence from the past two decades suggests that ineffective boardroom culture and behaviour have played a significant role in numerous failed mega-mergers and the near collapse of our banking system. Where was the board when Time Warner gave away half the World's most successful media business for a web portal that proved to be worth very little? In what way did the Royal Bank of Scotland board challenge bidding for ABN Amro at the peak of the credit boom? What prompted the Prudential Board to sign up to the takeover of AIG's Asian life insurance business at a cost disproportionate to its value?

These disasters and others like them have been described subtly by some as down to the ineffectiveness of the chairman to facilitate the board dynamic as a whole. Others have more brutally described them as the result of 'a domineering chief executive' with boards filled with 'cheerleaders'. Whichever explanation you prefer, ineffective boardroom behaviour and culture are implicated. The new UK Corporate Governance Code hopes to address this issue by making explicit the role of the chairman in creating a culture of openness, debate and effective challenge with the aim of promoting higher quality thinking and better decisions. The changes to the Code have put behaviour and culture firmly in the driving seat as key contributors to improving board performance and ultimately, business performance.

Thinking behaviour and the role of emotion

Most theories of decision-making and choice assume that decisions derive from an assessment of the future

outcomes through some type of cost versus benefit analyses. Yet studies on decision-making in groups show that individuals and groups are subject to systematic tendencies which deviate from rational analysis, this is known as 'cognitive bias'. Other studies of decision-making supports the view that there is more to decision-making than just rational logical thought and are derived from studies of neurological patients, i.e. people who can no longer process emotional information. These studies show that emotion is core to good judgement. By not being able to use emotion or 'gut feeling', good judgement and decision-making become seriously impaired.

In fact, these studies show that the more complex the decision the more emotional judgement matters.

Improving understanding of 'constructive challenge' and how it contributes to the quality of decisions a board makes requires more research. To date, the boardroom has largely been closed to external scrutiny and study. The detailed analysis of boardroom behaviour has been limited and much of what is known is extrapolated from one-to-one interviews, shared qualitative stories from one board director to another, or data collated by way of questionnaire. An understanding of how thoughts and thinking influence, and are influenced by, emotion and behaviour in the boardroom will help chairmen and board members improve their ability to stimulate the necessary challenge and high quality debate necessary for a truly effective board.

This article explores the links between thinking, emotion, behaviour and the subsequent outcomes. It offers insight and practical guidance to chairmen and directors about the nature of emotion and behaviour and how these factors influence the degree of challenge and the quality of thinking in the boardroom. Understanding these issues will be critical to the success of the new UK Corporate Governance Code and ultimately to UK business performance.

The challenge of groups

'It's not the mountain we conquer, but ourselves'.
Sir Edmund Hillary

Our experience of being and working in groups are often powerful and overwhelming. We experience the tension between the wish to join together and the wish to separate; between the need for a collective identity and an individual one. Many of the puzzling phenomenon of boardroom life stems from this conflict. In the boardroom the challenge of working in groups is magnified. Board directors must remain independent from each other and from the organisation over which they govern, yet they must be sufficiently consumed by the business so as to

make the best strategic decisions. The tension between independence and engagement is a challenge in its own right.

Studies of boards which have presided over major corporate disasters have shown over and over again that board members often see a disaster waiting to happen but typically fail to get the issue sufficiently on to the boardroom agenda. Data from a study of 2,500 boards in ten countries collated by Professor Andrew Kakabadse, indicates that raising issues in the boardroom is a challenge in its own right. The ability to get issues on to the agenda and to keep a board truly focused on the most important issues is in part at least due to the difficulties of group dynamics.

Psychoanalyst Wilfred Bion's work distinguished two main tendencies in groups; there is one tendency toward its primary task of work and a second, often unconscious tendency, to avoid work on the primary task by focusing on what he called the basic assumption. The basic assumption, according to Bion, means the irrational and apparently chaotic behaviour often seen in groups that stems from under-lying, mostly unspoken and often irrational fears.

Interacting successfully in groups and keeping focus firmly on the task of work requires group members to be aware of and attuned to the unconscious dynamic in the group as well as to the conscious task of work. Examples of basic assumptions might include continual delaying of a particular decision or attempts to create fundamental change. In a recent interview with a senior independent director, he remarked 'There is an intellectual dimension, you know the facts, but you need conviction to bridge the gap between reality and conviction to act. Boards struggle with the gap between rationality and conviction'.

It is the unconscious and often unspoken dynamics which create the culture of the group as well as shape group member experiences with regard to how effective or not effective the group is at completing its task of work. Particular behaviours, most notably empathy, (suspending judgement and attuning to the needs of others) and facilitation, (the act of making things easier, fulfilling a need or furtherance of an effort) and structure (agenda, clarity of role and clearly defined tasks) have a notable and positive influence in helping groups. These behaviours help to hold groups to a task by not allowing them to get distracted by any number of basic assumptions which give rise to complex thoughts, feelings and behaviour.

The challenge in not knowing

The work of the board is to resolve questions to which the right answer is not known: On what basis and criteria to make an acquisition? What do we want the future of our industry to look like? What is our risk appetite and how will we know if it becomes embedded as part of our culture? What role will we play in shaping the future of this industry?

Which components of the corporate governance code are most important to this organisation now? What will happen if we don't pay a dividend right now? The answers to all these questions lie in the domain of the unknown.

Being at the edge of what is known is not easy and gives rise to both feelings of hope and fear. There is hope that we might be part of changing something for the better and fear that we might fail. These emotions, conscious or unconscious are key contributors to the breakdown of group thinking process. In an effort to relieve the uncomfortable emotions the group focuses more on its basic assumption, rather than its task of work.

Paradoxically, board members are typically employed for their skills, competence, experience and knowledge within a particular field. At certain times during any decision-making process, it is likely that various individuals or sub-groups within the board will have more knowledge or experience in a particular field, at such a point the board is likely to be subject to a distraction from its unitary responsibility to make collective decisions; members are likely to line up behind the expert, unconsciously divesting responsibility for that particular decision and allaying each individual's fears of not knowing. The more persuasive the individual (through the use of compelling statistics and trends, analogy and visual stories) and the more powerful (hierarchically or socially within the group), the more likely it is this will happen. Known as the propensity effect visual effects are more likely to encourage groups to believe they are able to predict outcomes.

The chairman's role in such situations becomes vital in holding the group to its collective task of facing the uncertainty of not knowing and not deferring to the expertise of one to answer the question. The chairman's authority can be used to withdraw the power of knowledge. For example, by reminding the group that what is known from experience might not be sufficient to answer the question. The chairman can also ensure that he/she is stimulating the resourcefulness of the group to examine the problem in hand through their various different lenses. Various ways of doing this is by seeking alternative explanations (conceptual flexibility), extending the information available to include a broader or more systemic view of the problem (seeking information) and rebuilding, rethinking and collectively reframing an answer (forming concepts).

Promoting a culture of challenge, openness and debate will require a change of practice in the current boardroom.

Life at the top is one of permanent tension between the desire to do the right thing and not knowing what the right thing is. This requires that boards will see-saw between feelings of competence and feeling out of control. This is in itself a challenge that needs to be acknowledged and managed. Feeling out of one's depth or feeling as if one doesn't know can be considered information to be worked with in a way that helps a group understand how its thinking might be flawed.

What do we really mean by challenge?

'Never attack, always defend and defend well. In that way your attacker will learn an invaluable lesson' **Si Fu, Buddhist martial artist**.

'Challenge' has confrontational connotations as well as positive ones. It is defined variously as 'a call to a contest or competition', 'a demand for explanation or justification', 'a calling into question' or 'a test of one's abilities or resources in a demanding but stimulating undertaking'. But beyond that challenge is something that evokes at best high quality thinking and at worse, defence, fear and narrowing of thought.

In behavioural terms challenge can be observed as breadth and depth of questioning (seeking information); analysis and assimilation of information such that a new concept is formed (concept formation) and the multi-dimensional exploration of pros and cons, options and alternatives (conceptual agility, a behaviour that is highly predictive of success). These three behaviours, when observed in combination, are evidence of the quality of thought in the boardroom.

To be able to challenge others in a way that stimulates these behaviours is a demonstration of behavioural, emotional and intellectual horse-power. This requires empathy (the ability to be able to attune to the thoughts, feelings and paradigm of another) and engagement (the motivation, interest and desire) to work with others to think through a problem, issue or unanswered question. Effective challenge stimulates resourcefulness, creativity and even a playful state of mind. Ineffective challenge can stimulate the reverse, narrowing of thought and vision and a rigidity of the mind.

Negative behaviours such as denial, distortion or rejection of information; citing past experience as a reason not to explore current reality and rejection of alternative hypotheses are all behaviours that stimulate a sense of perplexity, anxiety and maybe even threat or fear. When humans feel threatened, anxious or seriously perplexed these feelings can induce a freeze, flight, or fight response. In behavioural terms in the boardroom this might be seen in reactive behaviour, rapid bullish justification (pushing back), silence (retreating in to oneself), or over rationalisation (vocalising logical rational reasons why the challenge is

irrelevant). A key role for the chairman is to be able to create the conditions for the positive behaviours to occur.

Emotions and thoughts are hardwired to behaviours and outcomes

We can think of the brain as two interconnecting hemispheres. The left hemisphere is the source of sense making, interpretation and explanation. The left brain is conscious, explicit, analytical, verbal, and rational. The right hemisphere is the source of originality, creativity and emotional growth and development. It is also the source of unconscious emotional processing. Therefore, the right brain is the unconscious, integrative, nonverbal, bodily-based emotional processes. Evidence from recent neurobiological studies demonstrates that integration and communication between and within the two hemispheres of the brain is vital both at a conscious and unconscious level.

As we develop, our emotional experiences are analysed, interpreted and made explicit from right to left brain, transferring through the corpus callosum, the information highway between the right and left hemispheres. The corpus callosum is the structure that enables this integration and communication between the two sides. When trauma happens in development we know that the transfer of information can be interrupted and emotional experiences and memories are stored deep in the right brain, disconnected from the left interpretative brain. When there is a disconnect of left from right, because of trauma, inadequate or incomplete learning then one feels a sense of disconnect. These thoughts are considered un-discussable or which makes no logical, rational sense. Ultimately, the combined processing activity of the right and left hemispheres gives rise to a coherent sense of oneself in the world.

The left brain can be thought of as the facilitator of the right brain. So for example, when we encounter an angry person, the negative emotion associated with the person will be processed first by the right brain. For the anger to be made sense of, then the left hemisphere must become involved. How we behave in response to that angry person will be shaped by two primary things; how we feel, our emotional reaction to anger, and how we make sense of it in the context in which we are. What we feel affects how we think and how we act. If the environment feels secure, and we have no unhelpful past experience of anger, then one will think openly and behave rationally. If the environment feels threatening, and/or one associates anger with trauma, one will think guardedly and behave in a defended manner.

Both positive and negative emotions are associated with thoughts and trigger actions or reactions. So, just as negative emotions trigger so too do positive emotions

trigger other types of actions. Negative emotions in particular are associated with behaviours known as freeze, flight or fight. In our modern, relatively safe environment, these responses freeze, flight or fight responses might not be initiated by fear of death, but they will be associated with security from an uncertain future. Positive emotions, however, also trigger certain typical behavioural response patterns.

Boards who understand the connectivity between emotion, thought, behaviour and outcomes will be better able to create a culture of constructive challenge within the boardroom.

In 1998, psychologist Barbara Fredrickson wrote a provocative paper titled 'What Good Are Positive Emotions?' The paper became a classic and it has helped to fuel the rise of the discipline of positive psychology. Fredrickson argues that, in contrast with the narrowing effects of the negative emotions, positive emotions are designed to 'broaden and build' our repertoire of thoughts and actions. Joy, interest, pride and contentment are positive emotions which evoke positive behaviours. *Joy* for example, makes us want to play. Play doesn't have a script, it is explorative and broadens what we will consider doing. When we feel playful we become willing to explore or invent new things. *Interest* broadens what we want to investigate. When we're interested we want to be involved, to learn new things, to tackle new experiences. We become open to new ideas. *Pride*, experienced when we achieve something, broadens the kind of things that we contemplate for the future, encouraging us to pursue even bigger goals. And, finally *contentment*, when we feel contented we are more likely to reflect on our achievements, integrate how we have achieved what we have and seek out ways to broaden the scope of our thinking. Positive emotions are associated with positive thoughts which in turn are associated with positive actions. Conversely, negative emotions are associated with narrowing thinking, blinkered thought and defensive or defending action.

We typically don't associate the emotions of joy, interest, contentment and pride with the boardroom. But with an understanding of the connection between emotion, thought

and action we can start to think of emotions as information in their own right. The conditions that enable boards and board directors to challenge and question effectively in a way that is likely to achieve this as a better outcome because emotion is both dialectical and dualistic.

Promoting a culture of challenge

Promoting a culture of challenge, openness and debate will require a change of practice in the current boardroom. Below are five practices that chairmen and board directors can adopt to help evolve the board's ability to improve the quality of thinking and ultimately, its decision-thinking capability.

1. **Adopt a thinking process** – thinking behaviours are highly predictive of strategic quality. Boards and executive teams who can differentiate between the behaviours of strategic thinking and decision-making and who adopt a process that requires the board to separate thinking from deciding are more likely to make better decisions and less likely to be derailed through cognitive bias.

2. **Consider emotion as a vital piece of data to be examined** – the legendary work of Bion showed how groups readily become distracted by irrational and sometimes chaotic behaviours. Boards like any other group will at times experience a whole range of emotions – frustration, anxiety, perplexity, fear, pride, hope and joy. The emotional life of the group is there to be worked with and if used wisely is vital data which can contribute to good judgement and sound decision-making. When the emotional state of the board is effective individual board members are more likely to be mentally resourceful, rather than blinkered or defensive.

3. **Ask questions which stimulate both an emotional and intellectual reaction** – our left and right brain are connected by a web of connective tissue. When the two sides work in tandem, emotions, connect thoughts which drive behaviour and outcomes. By asking questions of the board that stimulate both a cognitive and emotional response boards are more likely to engage the full range of human capacity.

4. **Attunement** – attunement means to engage in the moment with another. To be fully focused and centred to another individual, listening without judging – this is a powerful skill. When individuals experience attunement

from another they are more likely to say what they really think and feel. Attunement occurs when listening is active and judgement is fully suspended.

5. **Reflective practice** – reflecting on conversations and meetings is a natural part of our human daily lives, however rarely do we use this data as evidence of what is happening within the group. Reflective practice is a structured approach, directing, understanding and learning in groups as a means of self regulation. The concept was first introduced by Donald Schönxv in his book *The Reflective Practitioner* in 1983. The concepts underlying reflective practice are much older. The Meditations of Marcus Aurelius has been described as a prototype of reflective practice by Seamus Mac Suibhne. Marcus Aurelius has been lauded for his capacity 'to write down what was in his heart just as it was, not obscured by any consciousness of the presence of listeners or any striving after effect'. As a process it is fairly straightforward, the board sets aside time to review a situation, analyse the accompanying feelings, and to make sense of the experience. A 30 minute slot at the end of a board meeting (for a board of eight – ten people) is sufficient to consider what can be learnt from the day.

In summary

'The world we have created is a product of our thinking; it cannot be changed without changing our thinking' **Albert Einstein**

Boards who understand the connectivity between emotion, thought, behaviour and outcomes will be better able to create a culture of constructive challenge within the boardroom. The relational ability of the group and the ability of individual board members to attune to and work with the unconscious feelings that arise as a natural part of group life is a vital skill. These mostly unspoken dynamics can be considered clutter to be dismissed, ignored, or rather headed as a valuable source of additional information which the board can use. The information used effectively can help to better understand the resistances or catalysts to improving the boards ability to perform.

Good thinking process should not be optional in the boardroom; it should be considered good business.

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