

4th March 2010

Chris Hodge
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Dear Chris Hodge

A Joint Response to the review of the Combined Code from Alison Gill, CEO Crelos Ltd and Mannie Sher, Director of Work Group Relations, The Tavistock Institute

This letter is in response to your consultation on the proposed changes to the Code. Our aim in responding is to bring to the fore learning from social science, in particular research and practical application of behavioral psychology, leadership studies and group dynamics with an aim to improve corporate governance. It is our belief that the Code will be more likely to effect change and improve corporate governance if it uses the learning from psychological and social research.

Our comments are structured in four ways: Firstly we have identified where main and supporting principles and/or code provisions that to the best of our knowledge are verified by social science research or practical experience of social scientists. Secondly, we have suggested additions to or amendments to the main and supporting principles and/or code provisions that would bring the Code in to line with what is known through research or practical experience. Thirdly, we have identified content that may be useful to inform those seeking to provide guidance or advice to Chairmen and Boards on the behavioural and group dynamics of Boards. And finally, we have suggested areas that in our view need further study in order to encourage proactive consideration of how these issues might be appropriately tackled to inform changes to the 2012 review of the Code.

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We are in agreement with the principle of corporate governance in the UK. The use of a principles based approach and the “comply or explain” methodology in our view is more likely to promote better dialogue and thoughtfulness between investors, shareholders, regulators and the Board of directors. Human beings make ethical decisions using three broad moral consciences, which evolve throughout our lives: rule compliance (doing as you are told) is the first stage of moral development; social conscience (doing what is best for others) and finally principled conscience (integrity or virtue – the ability to make complex moral choices)¹. Compliance has as many negative connotations as it does positive. Simplicity, authority, social validation and guilt are powerful drivers of compliance. If the goal of the Code is to facilitate good governance it will be important in the future to consider how the Code can be written to encourage social and principled conscience evoking pride and efficacy in embracing the spirit of the code rather than merely ‘being compliant’.

Suggested additions to or amendments to the main, supporting principles and/or code provisions

Comments on: GOVERNANCE AND THE CODE

“The responsibilities in the board include setting the companies strategic aims, providing leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship”.

Our view is that this sentence lacks an important focus on the Board’s role in facilitating an appropriate model of leadership throughout the organisation. The wording implies power through a hierarchical chain of command not leadership and therefore followership and the facilitation of appropriate leadership throughout the organisation.

Leadership theories that have dominated UK corporations have been outdated models of ‘the exceptional leader’ where the focus is leadership being manifest in individual deeds of heroic proportions. This model of leadership has been discredited and the current financial crisis, where single leaders have been allowed to dominate and bring down organisations is further evidence of the inappropriateness of this model.

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A more appropriate wording to promote the Chairperson and Board's collective role in embedding effective leadership within the organisation might be:

“The responsibilities in the board include setting the companies strategic aims, providing leadership to put them into effect, facilitating and modeling appropriate leadership for the whole organisation and reporting to shareholders on their stewardship”.

CHAIRMAN'S PREFACE

Point 4, page 12: To follow the spirit of the Code to good effect, boards must think deeply, thoroughly and on a continuing basis about their overall tasks and the implications of these for the roles of their individual members. Absolutely key in this endeavor are the leadership of the chairman of a board, the support given to and by the CEO, and the frankness and openness of mind with which issues are discussed and are tackled by all directors.

Boards must not only think about their tasks and implications for members but they also must make one of their tasks to review how they operate. Boards develop dynamic processes based on norms, roles, relationships, development, need to belong and social influence. These processes affect Board behaviour. To mobilise the full resources of Boards demands that the Board identifies, acknowledges and works with these dynamics as part of its work. Where this is not done, unhelpful dynamics can develop which can inadvertently hinder the effective operation of the Board (e.g. through unspoken agendas or groupthink – see Appendix IV).

We believe that how the Board works on itself should be brought to the fore in the Chairman's preface in order to emphasize that collective responsibility is about collective responsibility for behaviour as well as results – i.e. how the Board achieves what it achieves and that this requires the Board to focus on how it behaves as a task of work in its own right. Bringing this point to the fore will help Chairmen and their Boards to think of evaluation not as a one-off event but as an ongoing focus which is critical to success.

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MAIN PRINCIPLES

SECTION A: LEADERSHIP

“The statement ‘the board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors’”

The concept of performance is primarily outcome oriented and focused on historical review; we recommend this statement should be amended to include a review of behaviour as well as performance; this would encourage a focus on behavioral and leadership issues.

A.3: The Chairman – Supporting principle

The role of the Chairman is described in its context as the effective leadership of the Board as a whole and with regard to communication with shareholders. However, no reference is made connecting the Chair role to effective leadership of the organisation as a whole, either directly, or indirectly through support and challenge of the CEO.

The Chairman has a key role to play in facilitating and modelling appropriate leadership directly and indirectly throughout the corporation. This important dynamic, connecting the Board to Shareholders and to the organisation is crucial to create an appropriate picture in the mind of the Chair, the CEO and the Board as the central glue upon which leadership is seen as distributed rather than owned in one individual (see Appendix II).

We would recommend that the wording is changed to include this element of the Chairman role.

SECTION B: EFFECTIVENESS

B.1: The composition of the board

At what point does remuneration become more than is necessary? The concept of independence is critical to effective functioning of a Board, therefore at the point that a NED becomes dependent upon revenue or the social status afforded from the role is the point that independence is likely to be compromised. Code provision B.1.1. Has no reference to independence from revenue acquired through a position on a board nor does it identify dependence as a concept (see Appendix III). There is a

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point at which even the wealthiest individuals and those of high social standing will find it difficult to be truly independent if revenue and recognition from any single Board appointment is a main source of income or social standing.

B.2: Appointments to the board

Succession planning and systemic strategic resource management is typically a considerable challenge for Boards and executive committees. The Supporting Principles state “that the board should satisfy itself that plans are in place for orderly succession”. Evidence from Grant Thornton’s ‘Moving Beyond Compliance’ Reportⁱⁱ, indicates that succession planning for the Board is an area that requires better focus. A plan can be a reactive process that will miss the key drivers of effective succession. Situations can change rapidly and radically triggered by events or shifts in issues that were previously regarded as unimportant. To improve succession management requires that the organisation has systemic processes underpinned by data. These processes would include at least annual review of roles and potential successors; active grooming for potential successors; creating new roles for potential successors; careful negotiation of HR policy restrictions, this will require distinguishing between law, policy and tradition. And finally, the organisation should aggregate data from different sources to assess key succession risks from multiple sources. With this in mind we would recommend that the goal of the Code should be more than establishing a plan, it should be to promote good practice in succession planning.

Possible wording might be:

- “The board should satisfy itself that there are effective processes for forming and reviewing succession plans and grooming potential successors”.

This would encourage the board to evaluate how succession plans are formed not just to focus on the outcome of the plan itself.

B.4: Development

Main Principle

The outcome of the Walker Report has indicated the importance of behaviour as a determinant of the long term performance of boards. Behaviour is the indicator of how work is achieved. Behaviour is observable, learnable and has consequences (both good and bad). The how is the critical component of long term success and

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sustainability. We would recommend that the Main Principle should be reworded as follows

“All directors should receive induction on joining the board and should have a clear plan and programme of development which is regularly reviewed to ensure that individual skills, knowledge and behaviour are actively developed to meet the needs of the business”.

B.6: Evaluation

Whilst there is a request for a formal and rigorous evaluation of the Board, the implicit emphasis thereafter appears to be on seeking resignation / new appointments and individual development plans - all which are important, but rather "individual" in emphasis. The concept of the 'Board as a whole' is something that is missing. All groups experience dynamics, it is acknowledging this and working through these dynamics with collective responsibility for positive interaction that a group maintains its effectiveness over time.

An effective evaluation needs to take in to account

1. Individual behaviour
2. Behaviour affected by role (Chair, Exec, NED)
3. The inter-relationships between individuals
4. The collective behaviour of the Board as a whole
5. The dynamics between the Board-as-a-whole and its sub-groups – formal (sub-committees) and informal (e.g. the resistors)
6. The dynamics of how the Board influences the larger system (organisation's culture) over which they preside

Finally, it would be prudent to include a statement on reporting the main outcomes and actions that the Board will undertake as a result of the evaluation.

C.2: Risk and Internal Control

There is regular use of system (e.g. "a sound system", "appropriate systems", "the company's system") - This language is in danger of misleading readers that its systems (e.g. computer systems or the like) that need changing - I would strongly

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advocate language such as systems, processes and behaviours, to emphasise the people side of what needs to change.

SUGGESTED AREAS FOR PROACTIVE RESEARCH PRIOR TO THE PROPOSED 2012 REVISION OF THE CODE

1. **Role definition:** We believe a significant area of study is the question of role definition of the Chair and non-executive directors. Crelos and the Tavistock would welcome opportunity to contribute to ICSA good practice guidance. In particular we believe there are two aspects of role and role definition that need further study in the context of good practice guidance for Boards. The first is the important requirement for roles to be dynamic and able to respond to the needs of the organisation. The second is the importance of developing roles to fit the needs of particular individuals. Humans typically are most motivated in roles in which there is opportunity to learn; performance is a function of both skill and will. Learning and development take place in response to needs, clear identification of the need and the consequence of not adapting is critical for learning to occur. A board like any other group needs to build roles around the needs of the organisation, the skills of individual board members and in so doing provide opportunity for development to occur.
2. **Moral development of Boards:** Research conducted by Professor Roger Steare indicates that education helps us develop our moral character. However, social conscience appears, our ability to make ethical decisions that consider the interests of others, appears to diminish with education. This is possibly due to the victory of reason over emotion. In his work there is uncomfortable evidence of low scores on the test of ethicability© for those working in technology, oil, utilities, banks and other financial services. These findings warrant further research and study in the context of the Boardroom.

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APPENDIX I

ROLES

Roles: are temporary, provisional, respond to the culture/needs of the organisation. They are inherently political and may be regarded as a space that is 'made for you'. And they require valency – a predisposition to behave in a certain way or to have a need met.

A role is defined as a person identifies the aim of the system they belong to and as that person takes ownership of that aim as a member of the system and chooses the action and behaviour that will best contribute to achieving this aim. Where a person doesn't have the requisite skills required of them in a role, they have a choice, to change the role or learn the behaviour, either course of action has implication for role congruence in the board.

Leaders are incomplete: the importance of role and the skills needed to take up a role: The role of a NED is an important discussion. Because organisations and Boards are complex and dynamic every NED and ED's role will be different. To be successful in role requires separation of the concepts of

- What is this role
- Who am I
- What skills are required to take up this role
- How will my role and role relationships work

More emphasis on consideration of the difference between the individual and the skills required to do the role is crucial to success. To keep pace with an ever changing organisation and markets Board members need to develop individually in to roles and collectively to manage the boundaries and potential conflicts between roles, individuals, role relations and the organisation in order to deliver their collective task.

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APPENDIX II

DISTRIBUTED LEADERSHIP

- The Tavistock Institute of Human Relations never supported the ideas of ‘exceptionalism’ and the now discredited ‘great man’ theory of history, nor did it support the trait theory of leadership that prevailed until the 1950s. Leadership that is exceptional is manifest behaviourally in individual deeds of heroic proportions, e.g. the discourse on transformation that attributes organisational turnaround, revitalisation, and performance excellence to high profile, larger-than-life figures. Exceptional leadership is ‘focussed’ leadership. Leadership behaviour is presumed to be concentrated in one or at best very few hands. It is a creature of hierarchically prescribed binaries – leader-follower; superior-subordinate.
- The Tavistock Institute & Crelos’ view is that the alternative to focussed exceptionalism is a conception of leadership grounded in the division of workplace labour: dispersed, shared or distributed leadership. Distributed leadership is grounded in the idea of the workplace as a community of practice that are the products of flexible work arrangements which may be found in (i) conventional organisational structures or (ii) across inter-organisational fields as a result of coalitions, joint ventures, strategic alliances, and partnerships. People may be members simultaneously of a number of cross-cutting and inter-connected communities. Role relationships in such communities of practice tend to be fluid rather than fixed, lateral rather than hierarchical, with terms such as “inter-dependence” and “reciprocity”, rather than “dependence” more accurately reflecting the members’ working engagements.
- The Tavistock Institute & Crelos are not in sympathy with the false promises of exceptionalism. Distributed leadership offers an expanded view of how organisations are led and the place of leadership in the articulation of work. We have asserted that every single organisational member may be influential and display leadership for at least some of the time and in a variety of ways. Distributed leadership may be understood as the aggregated influence of numerous individual agents, all suggesting that the spirit of distributed practice is broadly democratic.
- Margaret Follett, many years ago (1926), criticised the exaggerated significance of an authority figure’s order “as a larger part of a whole process that it really is”, because all the actions of the others that led up to and followed the moment of decision-making also needed to be acknowledged for a realistic appreciation of organisational conduct.

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APPENDIX III DEPENDENCY

Psychological Dependence is a dependency of the mind, and leads to psychological withdrawal symptoms (such as cravings, irritability, insomnia, depression, anorexia, etc). Addiction can in theory be derived from any rewarding behaviour, and is believed to be strongly associated with the dopaminergic system of the brain's reward system (as in the case of cocaine and amphetamines). Psychological dependence is found in activities and associations that drive particular behavioural patterns.

APPENDIX IV 'GROUPTHINK'

Groupthink is a type of thought exhibited by group members who try to minimize conflict and reach consensus without critically testing, analyzing, and evaluating ideas. Individual creativity, uniqueness, and independent thinking are lost in the pursuit of group cohesiveness, as are the advantages of reasonable balance in choice and thought that might normally be obtained by making decisions as a group. During groupthink, members of the group avoid promoting viewpoints outside the comfort zone of consensus thinking. A variety of motives for this may exist such as a desire to avoid being seen as foolish, or a desire to avoid embarrassing or angering other members of the group. Groupthink may cause groups to make hasty, irrational decisions, where individual doubts are set aside, for fear of upsetting the group's balance. The term is frequently used pejoratively, with hindsight.

1.1 *Origin*

Irving Janis, who did extensive work on the subject, defined it as:

A mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members' strivings for unanimity override their motivation to realistically appraise alternative courses of action. [1]

1.2 *Causes of groupthink*

Highly cohesive groups are much more likely to engage in groupthink, because their cohesiveness often correlates with unspoken understanding and the ability to work together with minimal explanations (e.g., techspeak or telegraphic speech). James Surowiecki warns against loss of the "cognitive diversity" that comes from having team members whose educational and occupational backgrounds differ.^[2] The closer

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group members are in outlook, the less likely they are to raise questions that might break their cohesion.

According to Janis, group cohesion will only lead to groupthink if one of the following two antecedent conditions is present:

- Structural faults in the organization: insulation of the group, lack of tradition of impartial leadership, lack of norms requiring methodological procedures, homogeneity of members' social background and ideology.
- Provocative situational context: high stress from external threats, recent failures, excessive difficulties on the decision-making task, moral dilemmas.

Three conditions under which groupthink occurs:

- Directive leadership.
- Homogeneity of members' social background and ideology.
- Isolation of the group from outside sources of information and analysis.

1.3 Symptoms of groupthink

Irving Janis devised eight symptoms indicative of groupthink (1977).

1. *Illusions of invulnerability* creating excessive optimism and encouraging risk taking.
2. *Rationalising warnings* that might challenge the group's assumptions.
3. *Unquestioned belief* in the morality of the group, causing members to ignore the consequences of their actions.
4. *Stereotyping* those who are opposed to the group as weak, evil, biased, spiteful, disfigured, impotent, or stupid.
5. *Direct pressure* to conform placed on any member who questions the group, couched in terms of "disloyalty".
6. *Self censorship* of ideas that deviate from the apparent group consensus.
7. *Illusions of unanimity* among group members, silence is viewed as agreement.
8. *Mindguards* — self-appointed members who shield the group from dissenting information.

Groupthink, resulting from the symptoms listed above, results in defective decision making. That is, consensus-driven decisions are the result of the following practices of groupthinking^[5]

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1. Incomplete survey of alternatives
2. Incomplete survey of objectives
3. Failure to examine risks of preferred choice
4. Failure to reevaluate previously rejected alternatives
5. Poor information search
6. Selection bias in collecting information
7. Failure to work out contingency plans.

Janis argued that groupthink was responsible for the Bay of Pigs 'fiasco' and other major examples of faulty decision-making. The UK bank Northern Rock, before its nationalisation, is thought to be a recent major example of groupthink.^[6] In such real-world examples, a number of the above groupthink symptoms were displayed.

1.4 Preventing groupthink

Janisⁱⁱⁱ devised seven ways of preventing groupthink (209-15):

1. Leaders should assign each member the role of "critical evaluator". This allows each member to freely air objections and doubts.
2. Higher-ups should not express an opinion when assigning a task to a group.
3. The organization should set up several independent groups, working on the same problem.
4. All effective alternatives should be examined.
5. Each member should discuss the group's ideas with trusted people outside of the group.
6. The group should invite outside experts into meetings. Group members should be allowed to discuss with and question the outside experts.
7. At least one group member should be assigned the role of Devil's advocate. This should be a different person for each meeting.

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About Crelos Ltd

Crelos Ltd are a privately owned company of business psychologists. Our work covers the assessment and development of high performing individuals, teams and organisations. Our area of specialism is applying psychology precisely in business to accelerate corporate change.

We work at the cutting edges of human performance working through conscious and unconscious challenges, for some of the UK's most successful organisations and those who are at the bottom of performance and in turnaround. Our work enables these businesses to differentiate through their people.

We work with both private and public sectors, principally but not limited to six sectors: Financial Services including PE&VC; Telecoms, Media & Technology; Education; Utilities; The Built Environment.

About The Tavistock Institute

The Tavistock Institute is a not-for-profit organisation which undertakes consultancy, research and professional development. We publish the scholarly journal Human Relations and host Evaluation - The International Journal of Theory, Research and Practice.

We help organisations learn and develop through innovation and change, working with the technical and emotional challenges involved.

We have consistently been at the cutting edge of participative and action research approaches and applied them, for example, to ground-breaking organisation and evaluation support.

We integrate different approaches from the social sciences to give our clients a deep understanding of their issues and potential ways forward. We bring assumptions to the surface and work with the unpredictable, including what is hidden, and sometimes, unconscious.

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