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SOFT GOVERNANCE

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The key to board effectiveness and impact

Boards may possess the credentials, qualifications, and skills to govern, but they are only as effective as the quality of interpersonal interactions between the board members.

The process of governing does not occur in a social vacuum. This is the lived experience of non-executive directors (NEDs) who hold multiple directorships and report different experiences in how accountability is practised on different boards, even for similar tasks. Decision-making behaviours are influenced as much by the social factors and context surrounding the decision as by the cognitive demands of the decision. Our research shows that these differences in lived experience are a result of the board group itself representing a social system embedded in complex power asymmetries and group identity effects. These social factors shape the use of decision influence and ultimately the exercise of accountability.

Differences in the social reality from board to board create an implicit understanding of the social order of things and can become a self-regulating dynamic. The dynamic exerts subtle pressure for unity, determining what

directors choose to do and say in exercising their influence over decisions, and how others' influence attempts are responded to.

Board research and practice associated with board effectiveness have long underestimated the role of human dynamics in and around the boardroom. Hard governance – the more formal instruments of accountability such as regulation, codes, and mandates – while essential because it provides the boundary conditions for good governance to thrive, does not guarantee it. Board dynamics or “soft governance” does.

Soft governance is largely invisible (even to those in the boardroom), poorly understood, and not given the attention it deserves. It is the sum total of the shared history of interactions and ways of working, stated or unstated expectations of directors, and their sense-making of board norms. Several government-sponsored inquiries and commissions have continued to reveal egregious lapses in soft governance both in the UK and in Australia. Recent reviews¹ reveal how the culture of an organisation and its board can undermine its formal governance accountabilities. These findings echo the 2013 findings² in which it was observed that “the culture of an organisation can defeat its formal governance.”

The dilemmas of soft governance

The work of the director is complex. There are three dilemmas in particular³ that all directors face, no matter how experienced they are:

- **Informed but heedful**

Information dilemma (vis-à-vis the very real challenge of information asymmetry): How do I engage with management in a way that ensures I get all the information I need to make decisions, but at the same time retain a healthy scepticism and find other ways to verify and calibrate what I am told? It requires trusting and mistrusting what one is told.

1 The 2019 Royal Commission into conduct in the banking and financial services sector led by Justice Hayne.

2 The independent review conducted in the UK by Anthony Salz of Barclays Bank following the LIBOR rigging scandal.

3 Research by R. Roberts, T. McNulty, and S. Stiles 2005.

- **Challenging but supportive**

Expertise dilemma: How do I use my expertise to provoke the kind of thinking and questioning of assumptions that I think is necessary, but still come across as supportive of management?

- **Detached but involved**

Role dilemma: As a NED, my relative distance from the day-to-day helps objectivity in what I see, which management, through their closeness to issues, may not be able to see. How do I achieve this without immersing myself in too much detail?

In theory, these dilemmas would be relatively easy to manage because corporate governance is based on the fundamental premise that trust and control are not mutually exclusive, and that a NED can engage in both trust-based and control-based behaviours at the same time. The reality may be harder to achieve as NEDs possess a variety of tendencies or propensities that make them more predisposed one way or another. Skill alone therefore will not help directors navigate the dilemmas of soft governance.

Board capital as the source of a director's influence

A director's background, experience, expertise, and exposure is the source of their identity on the board, characterised here as *board capital*. Far broader than the notion of skill, it is the sum of his or her human and social capital:

- Human capital relates to experience working with diverse and alternative business models; experience working with the diverse strategies needed to make those business models work; experience working with the assumptions underpinning those strategies; and experience working with the variety of consequences of actions taken as a result of those strategies. In essence, human capital relates to a NED's experience working with a diversity of mental models and schema.
- Social capital relates to the social networks and connections acquired through life experience across multiple domains, for example, intergenerational, geographic, educational, socio-economic status, and ideological (one's world view). When engaged in decision-making,

the diversity of NEDs' networks and connections guards against the narrowing of the ideological perspectives and strategic horizons of the board. It provides the NED with better contextualisation skills, especially at a time when the social licence of businesses is being closely scrutinised and the primacy of shareholder value challenged. In essence, social capital relates to the NED's social embeddedness.

Each NED uses an informal and subjective ranking of board capital as an internalised guide to his or her "place" in the group. It is also part of the human condition that we tend to place a higher value on our own career experience, and value the contribution of peers we judge as similar to us. This in turn creates trust-based affiliations and allegiances along board capital lines, generating a power dynamic which predicts how influence attempts in shaping a decision are likely to be mounted and received.

The power hierarchy and its self-regulating character

In the face of a power dynamic, directors are not just passive participants. They don't merely engage in mindless compliance with power structures when required to exercise influence. Instead they engage in conscious and deliberate attempts to gain approval, build rewarding relationships and enhancing self-esteem. Each director at the subconscious level makes an internalised calculation of where he or she sits in this power structure, and the strength of their desire to earn peer respect and acceptance. This internalised calculation shapes how, when, and why they choose to use the voice or remain silent during influencing episodes. Self-censoring divergent views, silencing self-doubt, or undertaking revisions of self-confidence may lead to unjustified support for the views of a powerful director – even when they hold a minority view. It may also lead to higher-power directors subliminally discounting others' contribution, rationalising away doubts or prematurely dismissing counter-positions.

These micro-behaviours create a set of norms and ways of working that advocates and exemplifies "what is acceptable around here," in effect creating the character of the board that becomes self-regulating. It creates pressure for unity and can act as a constraint on "deviant" behaviour because of the desire of a director to fit in as well as earn, retain, consolidate, and grow respect from their peers.

The critical role of director propensities

Faced with the pressure for unity, it requires a fair amount of energy and personal courage to push against powerful individuals and coalitions, and relies on more than the possession of skills or board capital. It relies on propensities to help neutralise the adverse effects of power differentials. In particular, it requires both the *propensity to influence* and the *propensity to be influenced* – and the character strengths these propensities imply. Both these propensities, which imply character strengths such as courage, confidence, fortitude, humility, openness, and candour, must be in balance, especially when facing subtle pressure to conform to the majority opinion. If they are not in balance, independent mindedness is compromised. Added to this is trust propensity: a generalised propensity to rely/depend on others and a faith in humanity shaped early in one's life. It shapes, for example, the degree of healthy scepticism one shows about what one is told.

The skills-based board, which has held sway for decades, is deeply flawed because it ignores the important role that the underlying propensities of directors play. Propensities are deeply wired and take considerable time to change. It requires significant effort to recognise the tendencies that hold us back from being personally effective. Current director selection and board development practices need a rethink.

A typology of culture types and the role of the chair

The chair plays a critical role in ensuring that no one person or subgroup has an oversized influence on deliberations and final decisions. The real challenge facing chairs is how to facilitate agreement and disagreement when faced with a diversity of viewpoints and perspectives. How do they allow robust debate and the proper contest of ideas to thrive, letting a debate run its course while maintaining the psychological safety required for all directors to feel secure enough to disagree with the chair and each other?

A typology of five culture types, shown below (moderated by the effects of power and identity), offers a chair a handy framework which can focus their efforts in improving board culture and managing the associated risks. It is not difficult to see how an overly agreeable board can emerge and how

Figure 34.1 High-performing board
Source: *Identity, Power and Influence in the Boardroom*, Abingdon, Oxon (Routledge, 2019).

chilling effects on the proper contest of ideas and independent mindedness may materialise.

A board is at its best when there is a healthy equilibrium between the effects of identity and power differentials. When members identify too strongly with each other, the contest of ideas and perspectives becomes less likely, groupthink emerges, and an overly agreeable board develops. The reverse is also true, giving rise to a fractured board. A productive tension between consensus and harmony on the one hand, and dissent and discord on the other, keeps a board dynamic healthy. Directors need to cultivate a taste for both harmony and discord in order to be effective.

Questions to ask

- To what extent is there a shared view on the board that good governance is achieved not only by exercising its duty of care and duty of diligence as prescribed by the law, but also through the quality of interactions and trust-based relationships?

- Does the board have a single shared view of its role in protecting and creating shareholder value, while at the same time aligning with the company's purpose and values? That is to say, are both value and values given equal importance in board deliberations?
- What steps can the board take to ensure there is sufficient cognitive and ideological diversity required to reflect the complexity of the sector it operates in and the broader communities it serves?
- Are individual director contributions drawn from the totality of their commercial experiences, allowing for broader individual contributions beyond a director's specific area of expertise or functional discipline?
- Do the number and scope of the committees reflect the complexity involved in governing the company, and are committee recommendations given diligent consideration by the whole board?
- Do the directors respect and value the distinctive strengths that each brings, actively seeking out and engaging with the views and contributions of each other?
- Are deliberations led in a way that allows all voices to be heard, and do directors feel safe to challenge and disagree?
- How consistently does the chair deal with any single director or subgroup of directors who may have an oversized influence on the direction, content, or pace of board decision-making?
- When faced with a diversity of viewpoints and perspectives, what steps does the chair take to ensure that agreement and disagreement are managed in a way that neutralises the effects of power asymmetries that inevitably exist?
- Are there formal and informal processes created in and around the boardroom to allow members to learn and grow together and reflect on the board's own effectiveness as a group, and is the closed session/in-camera session used for this purpose?
- What steps does the board take to continually refresh and renew its board talent, ensuring it is future-ready in the face of the transformative external forces of change?
- In its board renewal efforts, how much attention is paid to director propensities as compared to skills and experience to allow both consensus and contention to thrive in equal measure?
- To what extent do formal board effectiveness reviews surface and address the undercurrents that impede independent-mindedness, and

what steps does the chair take to systematically address the results of the review?

- How does the board ensure a culture of disclosure exists (over and above simply complying with their legal obligations under continuous reporting regulation)?
- How does the board ensure that management has the same shared view on the underpinning values of openness and transparency?
- How does the board become alert to a “good news culture” that might exist across all management levels?
- What steps has the board taken to ensure informed oversight through the unhindered flow of information between the board and management, characterised by mutual respect?
- How does the board and management ensure the advisers it engages provide advice that engenders trust with its community of stakeholders, rather than simply providing advice on legal protections?
- How does the board ensure that the moral compass used for decision-making is not a relative one, that is, that wrong is wrong even if everyone is doing it, and right is right even if no one else is doing it?
- How does the board ensure that management is viewing all decisions through the prism of public interest and scrutiny? Are *market values* given the same prominence as *market value*?