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<th>Behavioural and Psychological influences on Boards</th>
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Most “rogue” firms adopted best practice governance standards, as disclosed in their annual reports. With clever penmanship, governance can be made to look good in annual reports, with governance disclosures being ritualistic, symbolic and lacking substance in reality.

The global financial crisis points to something more than the best practice “usual suspects”\(^1\) (e.g., separation of chair and CEO, independent boards) as required for good governance. There is increasing recognition of the importance of hard-to-regulated features of organisations and their boards in corporate governance. This article examines the role of culture, behaviour and psychological biases in boardrooms.

**Influence of culture**

Official organisational policies specify what management wants to happen (laws/rules on the books). Corporate culture determines what actually happens – which rules are obeyed, bent or ignored (“laws / rules in practice”). Highlighting its importance, Justice Owen’s Report\(^2\) on HIH commences with a discussion of culture: “A cause for serious concern arises from the group’s corporate culture. By ‘corporate culture’ I mean the charism or personality—sometimes overt but often unstated—that guides the decision-making process at all levels of an organisation. In the case of HIH, the culture that developed was inimical to sound management practices. It resulted in decision making that fell well short of the required standards.”

Lloyd’s\(^3\) observes that studies of disasters often show that problems were not with processes but [that the processes] were ignored or over-ruled. Who is responsible for culture, the tone at the top, in organisations? Many would point to the board’s role here. However, in practice, employees will tell you that the CEO has the greater influence. Lloyd’s consider the internal communications and behaviour of senior managers is critical in setting the tone.

Table 1 summarises some key words to describe organisational culture, which in turn influences inter-personal relations, including communications. What terms would you use to describe the culture, inter-personal relations and communications in your organisation?

Communication is critical to good governance, not only what is said but also what is not said, as illustrated by one line from TS Eliot’s “The Rock”: “Knowledge of speech, but not of silence”. The importance of this kind of knowledge to boards has been referenced in the Walker Report (2009: 142)\(^4\) as follows: “The chairman, EDs and NEDs need to be experts on the ability to observe, interpret and draw conclusions from what people are giving clues about, but not talking about: that it, interpreting what lies just below the surface.”
Table 1: Language to describe the culture, inter-personal relations and communications in organisations

<table>
<thead>
<tr>
<th>Culture</th>
<th>Inter-personal relations</th>
<th>Communications</th>
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<tbody>
<tr>
<td>Collegiate</td>
<td>Friendly, supportive, warm,</td>
<td>Speaking up - Full, frank</td>
</tr>
<tr>
<td></td>
<td>trusting</td>
<td>open communication</td>
</tr>
<tr>
<td></td>
<td>Loyal</td>
<td>Guarded, superficial</td>
</tr>
<tr>
<td>Passive, Disengaged,</td>
<td>Unfriendly, cold</td>
<td>Information overload</td>
</tr>
<tr>
<td>Resigned</td>
<td>Polarising: in-group out-group polarisation</td>
<td>Obfuscation</td>
</tr>
<tr>
<td>Risk averse</td>
<td>Competitive</td>
<td>Weasel words</td>
</tr>
<tr>
<td>Confused, lacks direction,</td>
<td>Narcissistic</td>
<td>Silence</td>
</tr>
<tr>
<td>leadership</td>
<td>Hubristic</td>
<td>Whistleblowing</td>
</tr>
<tr>
<td>Chaotic, over-trading</td>
<td>Domineering, aggressive, bullying</td>
<td></td>
</tr>
<tr>
<td>Clash of cultures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Secretive</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Managerialist</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competitive</td>
<td></td>
<td></td>
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<tr>
<td>Likes risk</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Materialistic</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aggressive</td>
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Features of boardrooms conducive to behavioural and psychological influences

Boards and board behaviour cannot be regulated; nor can they be managed by structure and controls. Behaviour is dynamic, evolves and depends on the organisational situation, strategic context and group dynamics. Our desires strongly influence our behaviour. Human beings are susceptible to social influence. As the Walker Report comments: “Susceptibility to social influence is not a trait of those who lack will-power; it is hard-wired into all of us”⁵, going on to say “Board members need to be schooled in group relations, power dynamics and the behaviours and processes that are required to maximise the intellectual capacity of the group”. ⁶ A number of boardroom features affect behavioural and psychological influences.

Board size

Board size is important because of our cognitive limitations concerning with whom any person can maintain stable relationships. Eight to 12 people can know each other well enough such that the group’s potential to integrate thinking is enhanced and the potential for dislocation (feeling of not belonging) is reduced. Conversely, large boards increase the opportunity for leadership to be controlling and political.

Large boards are more likely to suffer from: (i) passive free riding, (ii) dislocation and (iii) groupthink. Passive free riding might manifest in the form of silence with board members unwilling to speak at meetings. Large boards may suffer from coalition building and factions. Selective channelling of information may be more likely on large boards. Finally, a divide-and-conquer approach may be adopted by more powerful board members such as the chairman and the CEO. Members may experience a feeling of dislocation on larger boards such that their participation and commitment decreases. Finally, groupthink may manifest on larger boards such that group members will try to minimise conflict and reach consensus without critically testing, analysing and evaluating ideas. Groupthink increases with larger groups, as groups’ motivation to achieve unanimity overrides their motivation to appraise
alternative courses of action. Another problem is group polarization. This refers to the tendency for groups to make decisions that are more extreme than the initial inclination of its members, following discussion. These more extreme decisions are towards greater risk if individuals' initial tendencies are to be risky and towards greater caution if individuals' initial tendencies are to be cautious. In addition, individuals can become committed to a group position, feel a sense of cabinet responsibility or don’t speak out when they disagree.

Large boards are often justified on the grounds of resource-gathering, e.g., large numbers of wealthy individuals on charity boards. The Walker Report contracts this, saying that resource gathering is not the function of boards – boards’ function is stewardship.

**Board chairmen**

Board chairmen are critical to board effectiveness: “[chairman’s behaviour] is both the source and result of an ability to mobilise others to share a vision of an anticipated future state of affairs and a willingness to collaborate to bring it about”. Board chairmen have to integrate boards’ collective thinking, have to be empathetic and promote openness in board members, have to facilitate interaction, have to develop others. Another trait of effective board chairmen is to communicate complex messages succinctly. The Walker Report divides the qualities required into (i) behavioural elements, which are classified as learnable components) and (ii) traits (which are intrinsic and innate components. Behavioural elements include facilitation, empathy, coaching, strategic thinking behaviours, influencing, building confidence, communication. Traits include physical vitality, stamina, eagerness to accept responsibility, need for achievement, courage, self-confidence, assertiveness and openness to new ideas.

**Board relationships**

The Walker Report also makes observations on board relationships, identifying three types: (i) Denial: boards’ discomfort arising for example from a lack of knowledge about a subject may be denied. (ii) Splitting: board may engage in splitting, relying on specialists for board decisions, which allows boards to distance themselves intellectually and emotionally from difficulties. This reliance on specialists may also lead to mistrust (“will the specialists try to pull the wool over our eyes”); (iii) Projection: attribution of feelings, qualities and intentions to others that truly belong to oneself (or to the board).

**Cognitive biases**

Subconscious thoughts cloud judgements. Behavioural theory tells us there are many unintended filters which distort the way we think about risk. Being aware of these biases will lead to clearer thinking and a better management of risk. Perceptions drive behaviour. For example, more attention is given to events which people dread, events which affect a lot of people, unfamiliar events.

Human beings misjudge risk. Our attitude to risk depends on how it is presented or framed. Risk descriptions phrased in positive language leads to an underestimation of risk. Emotion is also a driver of behaviour. Positive feelings and anticipated benefits associated with risk diminish the perception of that risk. Fear affects the ability to predict.
In turn, personality affects perceptions. Impulsiveness (venturesomeness) leads to a reduced perception of risk. Some people think they have a better than average ability to control risk. Desires influence risk appetite. Lack of observable downside increases belief in our abilities to avoid danger. Risks which confer benefits on people are ranked lower even when contrary evidence is available.\textsuperscript{13}

In 2011, the UK Financial Reporting Council implied the existence of bias in the board room for the first time using the phrase “distorted judgement”, acknowledging that flawed decisions can be made with the best of intentions and that competent individuals may believe passionately they are making sound judgements.\textsuperscript{14} Judgement of even the most well intentioned experienced leaders can, in certain circumstances, be distorted. Factors inhibiting effective decisions include dominant individuals, conflicts of interest/ self-interest, poor ethical standards, emotional attachments, Inappropriate reliance on previous experience and previous decisions, reluctance OF WHOM to involve non-executive directors and complacent attitudes.

The Financial Reporting Council recommends some steps to counteract distorted judgement, including boards being informed of the pre-boardroom processes to arrive at management proposals, pre-boardroom processes to challenge management proposals, commissioning independent review of management proposals, seeking advice from experts and deliberate introduction of a devil’s advocate to provide challenge, establishing a sole-purpose sub-committee, convening additional meetings, taking large decisions in stages, e.g., (i) concept – (ii) proposal for discussion, (iii) proposal for decision, executives put case at earlier stages Well in advance of point of decision so that directors have opportunity to share concerns and to challenge assumptions.

Our tendency to engage in self-deception can be key to distorted judgement. “If we can accept the fact that the human mind has an infinite, creative capacity to trick itself, we can guard against irrational, unethical decisions”\textsuperscript{15} There are four enablers to self-deception: (i) Language and euphemisms, (ii) Slippery slope of decision-making, (iii) Errors in perceptual causation, (iv) constraints from representations of the self. Examples of the use of language and euphemisms include: “aggressive” [not illegal] accounting/tax practices, “creative” [false, deceptive] accounting, “facilitator fee” [not bribery], “proforma” [false, deceptive] earnings, “collateral damage” [not civilian deaths] and the Catholic Church’s “mental reservations [not lying].

The slippery slope of decision-making may involve psychic numbing where repeated exposures to ethical dilemmas may produce a form of ethical numbing (this references back to the culture of organisations at the beginning of this article). The slippery slope of decision-making may also involve induction mechanisms (routinization) – If what we were doing in the past is OK, and our current practice is almost identical, then it must be OK.

Errors in perceptual causation involve focus on the person rather than the system, which may result in overlooking more likely causes of a problem. Self-interested motivations in assignment of blame – deflect blame from oneself. Acts of omission – withholding information that deceives. Failure to disclose the truth makes it harder to assign responsibility

Constraints from representations of the self. It is self-deception to believe we are objective. Our inability to have a truly objective view of the world means we cannot evaluate the effect of our behaviour on others.
Bias is an inclination to present or hold a partial perspective at the expense of (possibly equally valid) alternatives. Unconscious or sub-conscious bias is hidden bias, implicit bias. Do you suffer from unconscious bias? You can test yourself! Take the Implicit Association Test (IAT) which is available at https://implicit.harvard.edu/implicit/demo/.

It is importance to understanding social psychology. Desires powerfully influence the way we interpret information. When we are motivated to reach a particular conclusion, we usually do. Is there too much emphasis on technical and not enough on behavioural issues? Unconscious biased judgements versus deliberate conscious corruption. Unconscious bias cannot be deterred by threats of sanctions. Rooting out bias, or tempering its effects, will require more fundamental changes to the way [boards] operate. We need to recognise the existence of bias, and moderate its effects.  

There are a number of features of boardrooms that make them particularly conducive to bias.

- **Ambiguity** – directing is an art, not a science
- **Attachment to company/management** –
- **Approval** – boards endorse or reject management’s choices: self-serving bias becomes even stronger when endorsing others’ biased judgements
- **Familiarity** – people are more willing to harm strangers than individuals

Company directing is a fertile ground for self-serving biases

- **Discounting** – people are more responsive to immediate consequences than delayed ones. Boards may hesitate to implement tough decisions because the adverse consequences are immediate.
- **Escalation** – people conceal or wave away minor discretions: board biases may lead them to unknowingly adapt over time to small imperfections in management practices

Causes of bias

- Cognitive limitations in decision making
- Heuristics (to simplify decision making)
- Intuition
- Emotion
Table 2: Cognitive biases in judgement and decision-making

- Pattern recognition biases (we do not anticipate events outside the pattern)
- Saliency biases (focus on person we see, not forces acting on people we don’t see)
- Overconfidence biases (underestimation of risk)
- Stability (inertia) biases
- Anchoring bias (rely too heavily on a past reference or on one trait or piece of information when making decisions)
- Sunk cost fallacy (throwing good money after bad)
- Commitment bias (commitment to lost causes)
- Confirmation bias (belief perseverance)
- Groupthink (Bias fairly unique to boards [also to juries – see John Ford in Ten Angry Men] as boards make decisions in groups: Marnet [2010])
- Representation bias
- Availability bias
- Anchoring
- Hindsight bias
- Cognitive dissonance

There are ways of mitigating or overcoming bias. One approach is to introduce automatic stops in decision making in the form of circuit breakers, mental breakers or calling for time-outs and increasingly common feature of surgical theatres. Other techniques relevant to boards include refreshment of the board, limit terms of appointment, expert directors on board and bringing in outsiders. In relation to board decision making processes, decision making processes can be split up, take enough time to make the decision, change the dynamic in the board room to enhance quality of decision making, atmosphere to allow/encourage critical discussion, consensus should not be the order of the day, teach the board/board members how to challenge, introduce processes that allow reflection, consider the possibility it might be the wrong decision, find reasons not to agree with management’s proposals, allocate different roles within boards, instruct board members not to agree, devil’s advocate – contrarian directors, record pros and cons in the minutes, remove management more quickly after problems emerge.

Notes

5. Walker Report, op cit, p O/S
6. Walker Report, op cit, p 140
7. Walker Report, op cit, p O/S
8. Walker Report, op cit, p 140
9. Lloyd’s, op cit, p 4
10. Walker Report, op cit, p
11. Walker Report, op cit, p 140
12. Lloyd’s, op cit, p 4
13. Lloyd’s, op cit, p 4


Heffernan, Margaret [2011] Wilful Blindness. Why we Ignore the Obvious at our Peril, Simon & Schuster


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