

Key governance report

When does good governance lead to better performance?



PREPARED BY

Dr Robert Kay and Dr Chris Goldspink

Contents

Preface	4
Findings	5
1.0 Introduction	7
2.0 Governance and Performance: Getting to the right question	9
2.1 A focus on listed companies	10
2.2 The problem of proxy measures	10
2.3 Lack of consideration for contextual difference	12
2.4 Measuring performance: output, outcome and causality	13
2.5 Towards a better question	14
3.0 An ecology of governance	15
3.1 The Holling Cycle	15
3.2 Matching theory to experience	16
3.3 From effective to good	20
4.0 Governance is a team activity	24
4.1 Independence	25
4.2 Diversity of expertise and skill sets	27

4.3 Openness to alternatives	30
4.4 Trust	31
5.0 Board capability and its relationship to context	34
5.1 Patterns of decision-making during Conservation	35
5.2 Patterns of decision-making during Release	37
5.3 Patterns of decision making during Reorganisation	38
5.4 Patterns of decision-making during Exploitation	39
5.5 Implications	40
6.0 Summary and conclusions	41
7.0 References	43
8.0 Appendices	46
Appendix 1 — Methodology	46
Sampling	46
Interview approach	47
Coding	47
Quantification	48
Theory building	48
Theory testing	48
Additional analysis	48

Preface

This report is the first in a series of research studies to be initiated by the Australian Institute of Company Directors (AICD). It marks the beginning of what will become an ongoing research program into the nature and practice of good governance.



Findings

‘Good’ corporate governance is a team activity, with its primary process being one of collective sense-making. This represents a significant departure from the way in which the topic has been researched in the past and arises from a reappraisal of the purpose of governance itself.

‘The team’, as a single unit of analysis, should be conceived of as the board and executive leadership team. Whilst this may appear to conflict with the structural notions of independence, independence was overwhelming viewed as a mindset and characteristic of the individual by the Chairs, and a basis for the next finding.

Within ‘the team’, the Board provides the reflective capacity for the executive in order to improve the quality of decision-making. This is necessary in order to overcome failures of decision-making arising from issues of cognitive bias and the demands of senior executive roles, where the opportunity to critically reflect on decisions can be limited by time.

The nature of the decision-making challenge varies by circumstance. In this research, circumstance has

been conceptualised through four main phases involving processes of renewal, growth, stability and disruption. The Holling Cycle was used to explore these processes and found to be consistent with the experiences of the Chairs interviewed.

The greatest governance challenge existed when the organisation, or the environment in which it operated, was moving from one phase of the cycle into another. This required the board and executive to not only identify where they were in the cycle, but also predict the range of potential outcomes that could arise from alternative courses of action during the subsequent phases of the cycle.

Three key factors impacted ‘the team’s’ ability to achieve successful outcomes:

- **Perspective** — an ability to question and debate the assumptions informing the board’s assessment of the organisation’s situation, given its complexity and ambiguity

Within ‘the team’, the Board provides the reflective capacity for the executive in order to improve the quality of decision-making.

- **Scale** — the ability to appropriately frame or understand the implications of decisions across time and different levels of scale, i.e. division, organisation, market, economy
- **Prediction** — the ability of the team to use information and experience as a basis for predicting plausible future circumstances and their implications for the organisation

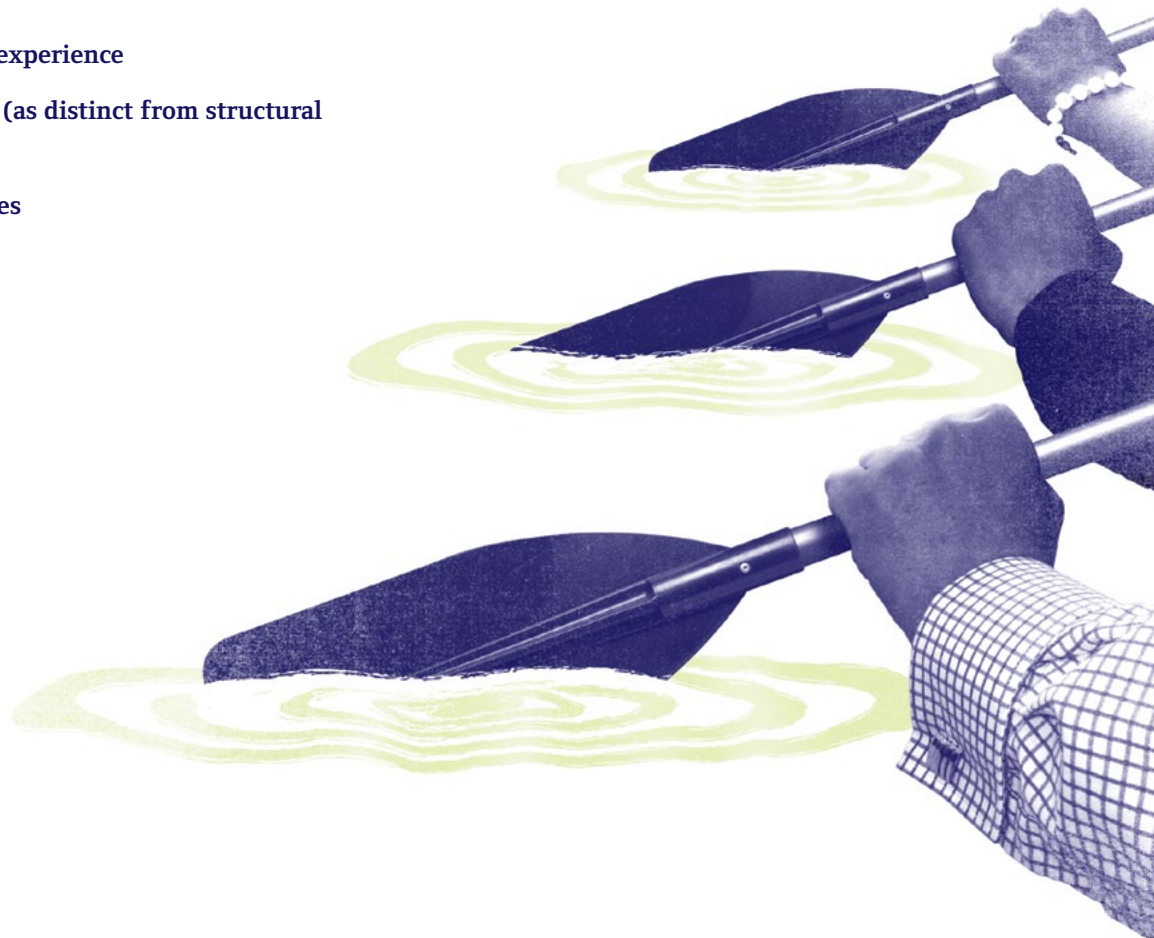
Whilst each of these factors present different challenges, the Chairs perceived the best path to addressing them lay in the selection, development and maintenance of an effective team (as described above).

The key attributes of an effective ‘governance’ team were:

- **Diversity of view and experience**
- **Independence of mind (as distinct from structural independence)**
- **Openness to alternatives**
- **Trust**

Of these attributes, trust between members of the board and the executive was seen as the most important factor. It enabled the other attributes.

The concept of performance varied significantly, depending on the sector and the organisation's stakeholders. This made a study of the causal relationship between governance and performance impossible with this data set. Indeed, many Chairs linked the concept of performance to the strategic objectives of the organisation, which in many cases are not generalisable. Furthermore, data showed that any discussion of this point must first address the difference between ‘outputs’ and ‘outcomes’.



1.0 | Introduction

This report is the first in a series of research studies to be supported by the Australian Institute of Company Directors (AICD). It marks the beginning of what will become an ongoing research program into the nature and practice of good governance. In this context, it seeks to explore the role of governance in organisations, suspending many of the common assumptions that are taken for granted and applied to such research. This is not to say that a considerable amount of very useful and well thought-out research on governance has not been conducted before, or that we will ignore what it has to say. Rather, it recognises that current commentary on the topic often adopts unquestioned assumptions about the role of boards, their composition and how they should function and be managed. Furthermore, it is often conducted without the benefit of speaking to the people who have the most experience of the challenge — directors.

In the context of major corporate failures, the onset of the Global Financial Crisis and other significant losses associated with failures of governance, there is obviously still much to be learnt about the topic. Indeed, the complexity and vast number of variables to be considered in the study of governance means that the use of traditional research methods may often be a key limiting factor in our ability to get to the heart of what ‘good’ governance is and how it can be improved. As such, rather than providing conclusive statements on the nature of ‘good’ governance or its impact on performance, this report will identify key assumptions to be built into a research program that seeks to provide these answers. It will highlight limitations in the way the topic has previously

been approached and, based on interviews with 100 Chairs covering organisations in the Publically Listed, Private, Not-for-profit and Public Sectors, provide pointers to the ways in which it may be explored in the future.

As a consequence, this is not a traditional research report. It will not follow an orthodox research report structure. Rather, we shall try to describe the topic of what constitutes ‘good’ governance by using the words of the Chairs we interviewed to reflect their lived experiences of how governance impacts on performance. Furthermore, we will introduce heuristics that enable us to look at the topic differently in order to lead us to ask better questions.

Lastly, the research presented in this report aims to be of practical relevance to directors — to help them think about their roles in new ways and ultimately lead to better practice.

The report begins in Section 2.0 by examining the way in which the topic has been explored previously and highlighting some of the assumptions that, in our view, have limited the way in which the topic has been discussed. The purpose of this section is to take us closer to research questions that can be usefully explored.

Section 3.0 introduces the Holling Cycle as a heuristic through which to examine the relationship between ‘good’ governance and performance. The choice of model is based on the data collected through the interviews coupled with attempts to address some of the shortcomings identified in the Section 2.0. Importantly in this discussion, we will attempt to highlight some of the key factors that distinguish the difference between general governance and

governance that may be characterised as ‘good’. This is not presented in terms of principles to follow, but the key challenges that ‘good’ governance must address.

Section 4.0 presents the central theme to emerge from the interviews with the Chairs — that ‘good’ governance is a team activity. The importance of this finding cannot be overstated. Taken seriously and deeply, it represents a significant change in direction from the literature and the general approach adopted in exploring the topic in the past, particularly as this ‘team’ is generally taken to include the executive. The characteristics, development

infancy when compared with other disciplines. Given its importance to the survival of our organisations and the challenges facing society more generally, a systematic and targeted research program is overdue. Governance cannot be studied in a test tube. It must be researched in the contexts in which it takes place, with people who live it day to day. The AICD is uniquely positioned to facilitate this research, primarily due to the access it provides, and its capacity to advance contemporary governance for tomorrow's organisations.

“ Good governance is a team activity... taken seriously and deeply, it represents a significant change in direction from the literature and the general approach adopted in exploring the topic in the past, particularly as this ‘team’ is generally taken to include the executive.”

and maintenance of effective governance teams, and the different circumstances they deal with, will form the bulk of this discussion.

Section 5.0 will examine how these team attributes address pervasive issues confronting boards as the organisations for which they provide stewardship are confronted by different environmental conditions.

Section 6.0 brings together the Chairs' views about team attributes, with the contextual lenses provided in sections 3.0 and 5.0 and with findings from wider literature, to demonstrate why these attributes do in fact appear to be fundamental. Research on governance, despite the many thousands of pages written on the topic, is in its

2.0 | Governance and Performance: Getting to the right question

At the heart of all research lies a question. The value of the research outcome often comes down to how well that question is formed and the assumptions underneath it. The first point that must be observed is that the question with which this work began — *does good governance lead to better performance?* — is not a great research question. It is a seductive one, but it is not a good one.

To understand why, it is worth undertaking a very brief review of the state of the literature on the topic.

There are:

- Roughly 1000 academic articles that claim to explore this question in some way.
- Approximately 50 per cent claim (with varying degrees of certainty) that there may be a positive relationship between good governance and organisational performance — the other 50 per cent are not so sure, or were unable to detect a relationship.
- About 20 per cent of these studies claim to be a ‘first ever’ attempt to answer the question in the particular way that they do, suggesting some experimentation with alternative approaches.
- The vast majority draw on economic theory that assumes organisations are composed of self-interested rational actors.
- Very few researchers appear to have actually spoken to anyone who is on a board, leading to what is often described as a ‘black box’ approach to understanding how governance takes place within the boardroom.

- Studies are frequently limited to the *board* as the unit of study, as opposed to broader conceptualisations of the decision making body in an organisation, i.e. the board and executive leadership team.

These last two points are perhaps the most important in terms of influencing the way the topic has been researched in the past. Put simply, our understanding of the relationship between good governance and performance has been largely defined by the types of data that researchers could gain access to, as opposed to any deeper notions of what good governance might actually be.

This presents three major challenges to our understanding of the topic:

1. There is a disproportionate focus in the literature on listed companies, limiting our understanding of other sectors.
2. Extensive use of proxy measures to assess the presence of ‘good’ governance and to define performance without first examining the nature of causality between the two.
3. The assumption that the relationship between good governance and performance looks much the same irrespective of contextual factors such as sector, economic conditions, stage of organisational life-cycle, etc.

Each of these challenges will be discussed in more detail.

2.1 A focus on listed companies

The reason for a disproportionately high focus on listed companies in the literature is accessibility of information. Because listed companies are required to publically report more information about themselves than private or not-for-profit organisations, there is naturally more information available about them that researchers can easily and cheaply access. This does not mean that publically available information is the most useful in terms of answering the question, but in the absence of anything better, it is what is used.

This situation is also driven by the dominance of a positivist-reductionist research paradigm that brings a limited methodological tool set to the research table. An indication of the degree of dominance of this approach can be seen by a fine-grained key word search we conducted as a part of this study. This search resulted in a sample of only 78 qualitative corporate governance studies, compared with the more than 900 quantitative studies. The requirement for large data sets in order to show some statistical validation not only significantly narrows the range of variables that can be explored, but also influences the way in which concepts that are critical to understanding good governance are defined. As such, the relationship between good governance and performance has been largely limited to a narrow range of factors. With respect to governance, these are commonly:

- Board tenure
- CEO tenure
- Separation of CEO and Chair role
- Number of independent directors
- Number of women on the board
- Number of meetings of the audit committee
- Number of enforceable undertakings
- Presence or absence of structural features such as independent remuneration committees

Performance is regularly limited to financial measures like:

- Revenue growth
- Profit growth
- Earnings per share
- Return on investment
- Tobins Q.

It is no coincidence that information about all these variables can be gleaned by reading an annual report.

2.2 The problem of proxy measures

Our understanding of what constitutes ‘good governance’ has not been helped by the limitations outlined above. The factors described in Section 2.1 have, in many cases, become proxies for defining what is considered ‘good’. Notions like diversity, which many Chairs in our sample argued are quite fundamental to good governance, are reduced to counting the number of women or minority groups on boards; while effective risk management is defined by the presence of a risk and audit committee. Softer factors, like the level of interaction between board members, have been reduced to counting the number of committee meetings instead of focusing on the quality of interactions.

The use of proxy measures such as these obscures key assumptions about the role of the board and its relationship to the executive. For example;

“ Much of the empirical literature examining how CEO-board relationships influence board involvement in firm governance is predicated on the assumption that effective boards influence corporate strategy and performance primarily by monitoring management on behalf of shareholders.”

(Westphal, 2010: 8)¹

¹ Theoretical support for the importance of board monitoring as a form of involvement is rooted in agency theory (Jensen & Meckling, 1976). From this perspective, the function of the board is to reduce agency costs resulting from the delegation of strategic decision making to top executives by monitoring managerial decision-making and performance (Fama & Jensen, 1983: 303).

“ ...governance is no guarantee of performance. Governance to me is to enhance the prospect for good outcomes...”

This assumption has significantly limited the way in which key characteristics of a board are interpreted. Take, for example, the presence and number of independent directors on a board. This factor is often cited as another proxy for ‘good governance’. However, due to the assumption that a board’s role is primarily one of monitoring management, the value of independent directors is focused on their ability to provide a more arms-length evaluation of executive proposals offered, without fear or favour (Johnson, Hoskisson, & Hitt, 1993; Wade, Reilly, & Chandratat, 1990), rather than the myriad other potential benefits an independent director may bring to an organisation such as experience in alternative organisations and sectors. Furthermore, the causal relationship between this independence and better performance (narrowly measured in terms of the variables described in Section 2.1) are barely explored at all. We would argue that understanding the causal relationship between the presence of independent directors and organisational performance, as an example, is somewhat more complex than simply counting the number of them and ignores if and how they add value.

In this sense, it is not surprising that the quantitative approach has struggled to identify a clear and consistent

correlation between the proxies used for good governance and the selected indicators of performance. More concerning is that it tells us little to nothing about the direction or nature of causation. Many studies assume (or at least seek) a direct relationship between good governance and performance (as opposed to an indirect one). The general consensus in our sample appeared to be that this is not a useful approach. The following quotes provide an indication:

[Chair 75]: ...governance is no guarantee of performance. Governance to me is to enhance the prospect for good outcomes, but very importantly to be the dashboard to light up and say, “We’ve got issues, we need to deal with stuff.”

[Chair 58]: I see governance as the enabler, rather than the driver [of performance]

[Chair 26]: ...I used to say that governance is a pre-requisite for performance, but not a guarantee. And the reason you have to say that is because we are all in the business of taking risk... we need to take some level of risk to justify our cost of capital and the returns that we need to make, and so it can never be a guarantee. So governance is definitely a pre-requisite, but ... more than that...I think it’s...a good lead indicator...of performance.

[Chair 86]: It would be wonderful if you could clearly demonstrate that good management, good governance, good leadership always ended up with good business, but it doesn’t work that way.

[Chair 93]: You can’t say that good governance leads to good performance.

[Chair 98]: ...good governance doesn’t necessarily lead to good performance. Bad governance increases the risk that there will be poor performance.

These views reflected the general observations by Chairs that the relationship is extremely complex, or certainly far more complex than it tends to be represented in the existing literature.

A central feature of this complexity lies in the distinction between performance viewed as ‘output’; and performance viewed as ‘outcome’ or impact. While the relationship between inputs (operating expenditure and capital) and outputs (units of service delivered or products sold) is largely within the control of the organisation (even if by way of supply contracts with other entities), the relationship between ‘outputs’ and ‘outcomes’ is far more complex. The outcomes associated with a service will be impacted by a wide range of factors that operate independently of the organisation (e.g. the general state of the economy, policy decisions of Government, the behaviour of competitors, etc).

So whilst there are input-output measures (generally taking the form of KPIs linked to strategy) with the assumption of a reasonably linear causation between input and output, approaches suitable for dealing with outcomes involve the formulation of hypothesised relationships between variables and the intended impact. The range, type, and quality of information needed to address these hypotheses can be quite different from that needed to address output performance questions. It is also less readily available as a by-product of normal organisational operation; more time consuming to collect and analyse; and what needs to be collected is likely to change over time.

The concern with this complex relationship between input and outcome is more likely to be found in the literature relating to the impact of government policy and administration (Campbell, 2001; Curristine, 2005; Heinrich, 2002) or on not-for profit sectors than in the commercial sector, where at least within the management research literature, a narrowly cast shareholder perspective rather than a wider stakeholder perspective has tended to hold sway. The Chairs, including those in private for profit

and the listed sector did not, however, confine themselves to a narrow output-based shareholder perspective on performance, but generally reflected a concern for wider stakeholder interests and outcomes. These points will be explored in more detail later in the report.

2.3 Lack of consideration for contextual difference

Contextual factors, many of which a board has no control over, play a crucial role in the performance of an organisation. As a consequence, it is reasonable to assume that what works to improve performance in one context will not be as effective in another.

We will argue that the lack of differentiation between context (in terms of sector) is potentially less of a problem in relation to understanding issues of governance and what constitutes ‘good’; but is a significant issue when considering what constitutes performance. The question of what constitutes better performance can be influenced by, amongst other things:

- The sector (be that industry or organisational type)
- Stage of organisational life cycle (start-up through to established firm)
- Ownership structure (single shareholder through to large diffuse shareholdings)
- Phase of the industry (growth or decline)
- Internal social dynamics unique to the organisation; and the list can go on...

Within the commercial sectors there has been a longstanding recognition that, while shareholders are concerned with the financial return on their investments, the long term viability of the company is influenced by the level of support it enjoys from customers, its public reputation and the degree to which it continues to enjoy a license to operate on the basis of its compliance with legal requirements. These issues have been responded to in the commercial sector with the advocacy of triple bottom line

accounting and various other accountability standards linked to indicators of broader social and environmental responsibility and, therefore, corporate sustainability (Cho, Lee, & Park, 2002; Horisch, Freeman, & Schaltegger, 2014; Seuring & Gold, 2013). The wider social and economic impact reflected in these outcome indicators present a much greater measurement challenge than financial or other indicators do. From a governance point of view, and because they relate to wider and longer term impacts, are arguably more important.

Within the not-for-profit and Government sectors, these issues are felt much more directly. These sectors are certainly concerned with outputs and the relative efficiency with which they can be delivered, as measured by conventional financial indicators. However, these count for little if it cannot be shown that the outputs delivered are consistent with outcomes experienced by the intended beneficiaries of the services being provided.

We are not the first to identify these limitations. Indeed, recognition of these problems have been acknowledged by a number of researchers.

‘ Most of the empirical literature has attempted to understand corporate governance in terms of agency theory and explored links between different corporate governance practices and firm performance. This literature assumes that, by managing the principal-agent problem between shareholders and managers, firms will operate more efficiently and perform better. This closed system approach within agency theory posits a universal set of linkages between corporate governance practices and performance and devotes little attention to the distinct contexts in which firms are embedded. Despite considerable research, empirical findings on this causal link have been mixed and inconclusive. Critiques of agency theory have pointed out its under-

contextualized nature and hence its inability to accurately compare and explain the diversity of corporate governance arrangements across different institutional contexts’.

Aguilera, Filatotchev, Gospel, & Jackson, 2008:475

2.4 Measuring performance: output, outcome and causality

Despite focusing on the least problematic aspects of performance — financial output indices — the issue of causality (endogeneity within the economics literature) is a persistent problem (Schultz, Tan, & Walsh, 2010). Within the literature, the problem has typically been cast as one of methodology. However, reciprocal causality and the existence of vicious and virtuous cycles in the relationship between performance and governance may be a more substantive issue than has typically been assumed. There is, in fact, no reason why the causality should be one way, and every likelihood that it is complex and non-linear (Duit, Galaz, Eckerberg, & Ebbesson, 2010; Duit & Galaz, 2008).

If we accept the above, we are left with a situation where there is no universal and objective definition of what ‘good’ governance is or might be. Rather, the nature of ‘good’ governance must be judged in relation to context. What appears as ‘good’ from one perspective may appear as ‘poor’ to others. The same may be said of ‘good’ performance, as this also differs depending on the stance of different stakeholders. The inter-subjective nature of this problem is revealed through the following quote from one of our interviewees.

[Chair 68]: ...a lot of it is relative performance, ... look at XYZ, it lost \$300M in the last three years. Is that good performance? In a relative sense it's outstanding. If you look at it from a perspective of a shareholder who hasn't got a dividend, he thinks it's lousy. So it's all how you perceive these things.

Whilst it may be tempting to discount some positions as ill-informed or subjective, even these can be very real and materially impact an organisation's performance. An example is the boycott of Shell as a result of that company's handling of the Brent Spar issue in 1995. This had a very material effect on Shell's bottom line (Watkins & Passow, 2003).

Significantly, none of the 100 respondents we interviewed advocated a retreat to simplicity by ignoring all but the owner's interests as revealed in short term financial outputs, reflecting a concern for wider and longer-term stakeholder interests and seeing it as fundamental to their role.

An awareness of these problems has significantly influenced the approach adopted for this research and leads us to suggest an alternative framing of the guiding research question.

2.5 Towards a better question

Based on the discussion above, there are clearly problems with 'Does good governance lead to better performance?' as a research question. It fails to deal with organisational realities that board members experience and assumes one size fits all when clearly this is not the case. So, in short, we need a better question. For this study we will take a sideways step on the topic and ask the question:

Under what circumstances does good governance lead to better performance?

This question will involve an examination of:

1. What constitutes 'good' in different contexts; and
2. How is performance conceived in different contexts?

Our primary purpose for this shift is to explore the factors involved in developing a more nuanced notion of what 'good' is, and the different ways in which this can relate to performance. In doing so, we will attempt to illustrate a greater degree of the complexity involved in order that

some of the causality existing between the many variables can begin to be understood.

The research methodology adopted, therefore, represents a departure from the majority of studies conducted so far. A detailed description of the approach is included in Appendix 1. In short, it involved a qualitative approach including semi-structured interviews with 100 Chairs of Australian organisations. The Chairs were drawn from each of the major sectors that the AICD serves — Publically listed, Private, Not-for-profit and Public. Many of the Chairs held roles in multiple sectors. The content of the interviews cast a wide net in terms of exploring the different ways in which the Chairs perceived good governance and its relationship to organisational performance — adopting, as much as possible, a 'blank sheet' approach to the topic. All interviews were recorded, transcribed and then coded in order to identify key patterns in the way the Chairs considered the topic. Initial analysis of the coding provided a basis from which different theoretical frameworks could be introduced to help provide further structure to the way in which the data was interpreted and analysed.

The choice of theoretical framework was based on an exploration of a range of different literatures that responded to the issues described by the Chairs. These included, but were not restricted to, contingency-based research into boards; behavioural science (in relation to high performance teams); cognitive sciences (including decision theory); organisation science; and systems science (particularly that pertaining to system adaptability and resilience). Each framework addressed different patterns that emerged from the interview data.

Section 3 will describe the Holling Cycle (Gunderson & Holling, 2002) which emerged as the most appropriate framework to understand the contextual governance challenges faced by directors. By examining the research data through this framework, we will begin to develop a new understanding of what 'good' might mean.

3.0 | An ecology of governance

Accepting the general critique of an often under contextualised approach to understanding governance, a ‘contingency’ literature has begun to develop in relation to the subject (Aguilera et al., 2008; Desender, Aguilera, Crespi-Cladera, & García-Cestona, 2012). This approach argues, and provides empirical support for, ‘good’ governance depending on circumstances; and specifically includes the effect of different ownership forms on governance as well as sectoral and industry differences. Importantly, this body of work also suggests that governance needs to play a different role depending on the organisational lifecycle stage and in response to differing environmental conditions. Governance is simpler where there is environmental stability. Indeed, many academic commentators tacitly, if not explicitly, frame the role of governance as being to maintain stability.

An area of research that has engaged with the challenge of understanding the way in which natural systems move between phases of stability and disruption is ecology. This literature also extends to a consideration of the interaction between natural and social systems, as humans not only use natural resources but also try to manage them. In this sense, the concept of governance is linked to that of organisational resilience — where governance is directed at influencing an organisation’s performance as it moves through ongoing cycles of periodic shock and maintaining consistency by reducing the adverse impact of booms, busts and crises (Duit et al., 2010; Rigg, 2011). One of the primary contributors to this literature is the ecologist C.S. Holling (2001). Holling distinguishes between two concepts of stability. One focuses on efficiency,

control, constancy and predictability, which he argues is appropriate when uncertainty is low. The other focuses on persistence, adaptability, variability and unpredictability, and is argued to be appropriate where uncertainty is high (Gunderson and Holling 2002).

3.1 The Holling Cycle

While it has become a truism that modern business confronts high levels of change and uncertainty, it is more accurate to characterise this as somewhat periodic, with periods of relative stability punctuated by periods of change. Furthermore, this change occurs across different time cycles and at different levels (i.e. team, organisation, industry, market, economy). This thinking led to the development of what has become known as the Holling Cycle — a model of cyclical change — to help guide the choice of strategic stance appropriate to different environmental circumstances.

The Holling Cycle² (see Figure 1) is divided into four phases or states through which a system is continuously travelling. Holling refers to the most stable of these phases as Conservation. During the Conservation phase the focus is on consolidating the organisation’s position in the market and aligning organisational investments and processes to service it in an increasingly efficient manner. This is typically the longest lasting of the four phases, and, in terms of responding to and harvesting a market opportunity, could span many decades.

² A detailed description of the Holling Cycle and associated research can be found in Gunderson and Holling (2002)

At some point a market disruption will trigger a shift to the next phase in the cycle, in Holling's words, a Release. This may be due to a change in consumers' preferences; a technical innovation rendering existing products or services obsolete; or just simply result from poor management and an ensuing failure. During this phase the capacity to deliver value reduces rapidly and previous inter-dependencies necessary to service the market effectively and efficiently break down and become liabilities rather than assets. Holling links this phase to Schumpeter's (1945) 'creative destruction' stage of a business cycle.

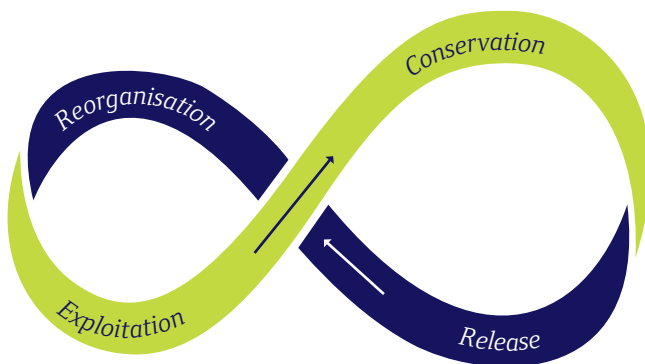


Figure 1: The Holling Cycle

The Release phase is followed by the need for Reorganisation. During Reorganisation existing assets and systems are abandoned or sold, thereby freeing up capital for re-investment. This Phase is associated with high levels of innovation, uncertainty and instability. The old business models, destroyed during the Release phase, are yet to be replaced by a new dominant approach. Many small and minimally connected organisations form in response to a perceived market opportunity and innovate, particularly with regard to business models, in an attempt to colonise the new opportunities.

It is then that activity moves to the fourth phase of Exploitation. Here the multitude of small activities that

“The question in terms of what constitutes ‘good’ governance is whether the decision making body of the organisation has the capacity to effectively manage the different challenges inherent in each of the phases, such that organisational performance across the whole cycle is improved”

characterised the Reorganisation phase are reduced to a few dominant models that prove most effective at capturing the available resources and maximising value from the environment. Innovation is also prevalent in this phase, but more focused on finding increasingly effective and efficient production processes to underpin the new business models. And so the cycle continues back into Conservation.

All the phases of the cycle are inevitable, necessary and, most importantly, unavoidable. An interesting finding from the ecological research is that attempts to forestall a release cycle (such as preventing a forest fire by minimising the risk of fires starting) can lead to a more cataclysmic release when one does eventually occur (resulting from the accumulation of high fuel loads from fires becoming

increasingly rare and more distant in time). This poses interesting challenges in an organisational context. At the level of the global economy, the establishment of large oligopolies (that are too big to fail) can lead to a capacity for market dominance, which can forestall Release, precipitating a major crisis when they do fail (as we experienced through the GFC).

“ If good governance is to a substantial degree about how we deal with uncertainty and ambiguity, then our capacity to predict under these conditions becomes a core competence.”

The question in terms of what constitutes ‘good’ governance is whether the decision making body of the organisation has the capacity to effectively manage the different challenges inherent to each of the phases, such that organisational performance across the whole cycle is improved, or indeed can anticipate or even trigger movement between phases. A study undertaken by the authors in 2012 concluded that CEOs identify three forms of resilience, each dependent upon the one that comes before. The levels were an effective business as usual capability; the ability to change and adapt; and shaping the environment. **The final category of shaping was described as existing where:**

“...the focus of the organisation is to actively create the environment it operates in, either through the innovation of new categories of products and services, the influence of regulation, or fundamental reinvention of the industry in which it operates “

(Kay & Goldspink, 2012: 18)

The CEO research is strongly suggestive of an approach that involves initiating transitions between phases to the advantage of the company, rather than simply responding to them as externalities. The same orientation was found in the approach suggested by several of the Chairs interviewed for this current research. Like the CEO research, however, these Chairs represented a small minority — less than 10 per cent of the sample.

3.2 Matching theory to experience

A key element of the interview process used during this study was to ask the Chairs to relate stories of instances where the board needed to make a decision that would impact on the performance of the organisation. Significantly, we asked each Chair for two stories drawn from their personal experience:

1. A situation where the board made a decision involving issues of governance, with the result of that decision being that organisational performance achieved or exceeded expectations and,
2. A situation where the board made a decision involving issues of governance, with the result of that decision being that organisational performance failed to meet expectations or it declined.

Whilst some interviewees told long and detailed stories, others provided short vignettes that illustrated the different concepts they felt were important to understanding governance. Across the 100 interviews, this process resulted in 411 vignettes describing instances of governance that covered a wide range of circumstances.

To test the applicability of the Holling Cycle to understanding the interview data, we reviewed the vignettes and coded them according to how well they matched a particular phase of the Holling Cycle. Figure 2 shows the results of this exercise.

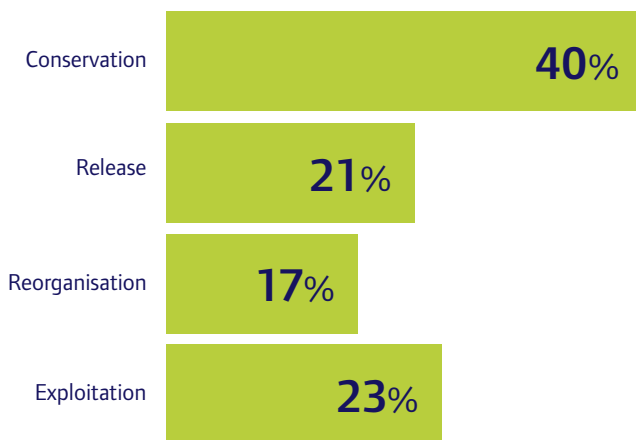


Figure 2: Percentage of vignettes by phase of the Holling Cycle

Consistent with what we would anticipate from the theory, the highest proportion of stories (40 per cent) described instances of governance characteristic of a Conservation phase. We would expect there to be more Conservation stories in the sample because, for the vast majority of the time, boards will be dealing with decisions involving the Conservation of business as usual. Consequently, more of the Chairs’ experiences would be in this phase. An additional reason why we would expect to see more stories classified to Conservation is that this is often seen as the most desirable state. At the level of the economy as a whole, it is the ‘equilibrium’ to which the system should return after a shock. It is also a relatively stable state that forms the focus of most management methods. It is the most controllable and, therefore, predictable state within which most managers would want to keep their organisation for as long as possible. It is important to note

we are not claiming that these numbers are statistically valid or representative of the actual time board members spend dealing with issues of governance in each of the quadrants. Rather that, because the stories could be easily and consistently categorised into each of the phases, the Holling Cycle presents a useful metaphor and explanatory framework for thinking about issues of governance.

Interestingly, but perhaps not surprisingly, when we split the sample in terms of those stories the Chairs considered to be positive and those that were negative, the Release phase was associated with a significantly higher percentage of negative stories (55 per cent) compared with the others (ranging from 29–35 per cent). Figure 3 shows the comparative breakdown of positive and negative stories across the four phases of the Holling Cycle.

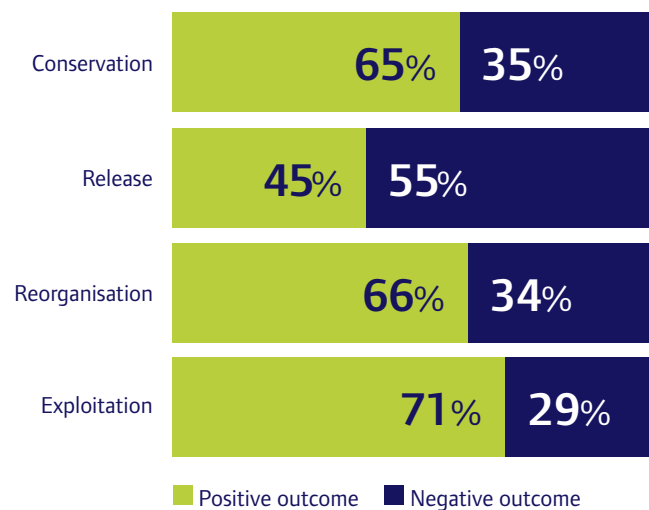


Figure 3: Breakdown of vignettes by positive and negative stories

This presents an interesting paradox and our first distinguishing characteristic of ‘good’ governance — as opposed to governance in general. The Release phase of the Holling Cycle is inevitable in all natural systems including social systems like organisations. As such, while

it may be within the power of the board to influence the timing and extent of a Release, it is not something that can be avoided altogether. Therefore it seems logical that the board's capacity to pre-emptively and successfully 'read' the environment and guide the organisation through a Release phase is critical to the notion of 'good' governance. Furthermore, we could hypothesise that it is during the Release phase that the effect of 'good' governance is most easily discerned.

Interviewer: So, when does good governance lead to better performance?

[Chair 98]: Well it probably always does, but it's hard to show... But in the crisis... that's when you'll see it. And I would think there'd be lots of examples that you would gather from around the world that would show that.

The picture is not, however, as straight forward as this. Whilst a crisis may expose to the outside world the quality of governance present in an organisation, from the perspective of those involved the more vexing governance problems were experienced when things were going well, ie when there was no particularly compelling reason to change what was being done.

[Chair 98]: ...I think the trick is, when you are humming, to introduce new things...that's one of the hardest things for companies to do when things are going well.

It is in this context that the ability of the board to support the executive in anticipating and triggering Releases at various levels of scale is important. The oft heard call for a 'burning platform' to get things done relates to this problem. What these observations serve to illustrate is that the challenge of 'good' governance is necessarily different at differing stages of the Holling Cycle. What may be deemed 'good' in some circumstances may be far from good in others. From the point of view of understanding the relationship between governance

and performance, acceptance of this point makes the task considerably more complex.

The ability of the board and executive team to navigate the phases of the Holling Cycle may not be sufficient to constitute 'good' governance; it may be effective but not 'good'. There are two critical factors associated with the Holling Cycle that, in our view, must be addressed if we are to move beyond effective governance towards 'good' governance.

3.3 From effective to good

If we accept that the Holling Cycle provides a useful integrating framework for thinking about the challenges of 'good' governance, there are three critical factors that impact on the ability of the board and executive team to deliver a superior outcome:

- **Perspective** — An ability to question and debate the assumptions informing the board's assessment of the organisation's situation, given its complexity and ambiguity.
- **Scale** — The ability to appropriately frame or understand the implications of decisions taken at one level of the organisation (eg. business unit or division) on activities and performance at a different level of organisation (eg. the overall enterprise or, as in the case of the GFC, on the economy as a whole). Also see example 'Failing to predict across scale' below.
- **Prediction** — The ability of the team to adequately predict changes in the environment of the organisation at a future point in time. In other words judging the right time to make a change.

The ability of the board to effectively deal with these challenges adds considerable complexity to the challenge of governance and gives significance to many of the factors that the Chairs associated with 'good'. Before describing the characteristics the Chairs discussed, these three factors will be described in more detail.

THE IMPACT OF PERSPECTIVE ON DECISIONS

In October 1973, Flight 114 took off from Bengazi airport for its regular flight to Cairo. Initially all appeared normal, but a combination of weather conditions (a sand storm obscuring their view and strong tail winds) meant that when the crew thought they were approaching Cairo, they were actually about to cross into the Israeli occupied Sinai Peninsula.

Due to the recent 6-day war, relations between Egypt and Israel were tense, with the Israeli's receiving warnings of potential terrorist attacks. As Flight 114 came onto their radar, well away from any routes flown by commercial aircraft, concerns were raised. Two F4 Phantom fighter jets were scrambled to intercept the unauthorised flight.

On board Flight 114, the Captain contacts Cairo tower (whose approach radar was out of service), and is given clearance to land. Three minutes later the Israeli jets rendezvous with Flight 114 and signals to the airliner to land (radio contact isn't possible due to incompatibility of equipment). Flight 114's aircrew misidentify the fighters as Egyptian MIGs and think they are being provided an escort. The airliner lowers its landing gear.

Flight 114 makes its approach to what the aircrew initially believe is Cairo International, then realise it is a military airport — possibly Cairo East, a military installation. In fact it is Refidim military base in the Sinai Peninsula. The crew raise the landing gear and turn west towards what they believe will be Cairo International.

The Israeli pilots are confused — the airliner understood their request because they lowered their landing gear, now they seem to be trying to escape — they must be terrorists. They fire warning shots across the front of Flight 114. The crew, confused, ask Cairo “why their MIGs are shooting at them”. Failing to get a response, the Israeli's initially fire at the airliner's wing tips and then the base of its wings, forcing it to crash land, killing 108 people. The flight recorder indicates that the co-pilot realises they are Israeli jets just before they crash.

Perspective

Consistent with the stance adopted by its authors, we would suggest the Holling cycle is a heuristic device or a metaphor, not a theory. In this section we discuss why this stance is necessary and, in so doing, point to some of the challenges and difficulties of working with this approach in practice.

As discussed, the Holling cycle involves four phases and we have argued that each phase presents different governance challenges. However, the process of determining where the organisation is at any given time involves judgement. There are no clear and unambiguous markers that can tell us which phase we are in. Moreover, making a judgement that we are, for example, entering a Release phase, and acting accordingly, could trigger the advent of the anticipated transition, even if it was not imminent, based on the state of the economy, market or organisation.

The decision process involved in judging the phase, and interpreting its implications, suffers from all of the same challenges as any other decision process — it is subject to a range of ‘cognitive biases’. It is for this reason we would suggest it is best conceived of as a sense-making process (Houghton, 2013; Snowden, 2002).

“ the process of determining where the organisation is at any given time involves judgement. There are no clear and unambiguous markers that can tell us which phase we are in.”

“Sense-making involves the ongoing retrospective development of plausible explanations that rationalize a situation or circumstance.”

Weick, Sutcliffe, & Obstfeld, 2005: 409

Basu and Polazzo explain that:

“The mental models or frames that underlie organisational sense-making, then, influence the way the world is perceived within the organization, as well as critical decisions with respect to perceived external and internal demands.”

2008: 123

What to one person is a crisis or a fundamental shift in the market that requires a radical rethink of business strategy may, to another, be a challenge that is expected to be transient with a subsequent return to business as usual. Furthermore, the interpretation may also vary between the individual director and the board overall.

How alternative assumptions are brought into contention and managed can very much influence the quality of the resulting judgment and have a material impact. Significantly, in terms of working towards an understanding of ‘good’ governance, that impact may not be at one or even the expected level of the system. Philip Auger (2011) has suggested, for example, that the GFC emerged as a consequence of risk assessors and product developers in the financial services sector all acting on the basis of a widely shared paradigm (that of the efficient market hypothesis) and making rational decisions about how to manage risk at the enterprise level in a manner consistent with that paradigm. The emergent consequence of the actions taken at the enterprise level was to precipitate a Release at the level of the global economy; an unintended consequence of some considerable magnitude!

Making decisions across multiple levels of scale

The above discussion leads us to the second challenge with the use of the Holling cycle — it is not a single cycle.

Rather, the authors describe it as nested, with cycles within cycles. Production and managerial processes, and the social and material transactions that define them, are generally organised — and indeed can self-organise — into levels. Each of these levels will also exhibit phases and can be analysed using the Holling cycle heuristic. Each level, though, does not operate in isolation. For example, the processes associated with a supply chain interact with processes associated with manufacture, which interact with processes associated with distribution and sales and all of these have implications for the business performance of the organisation of which they are a part. Each is characterised by flows and exchanges happening within particular time cycles. Cycle times at the lower levels are likely to be faster than that at the higher levels. Each may also have non-linearities associated with it, such as threshold events, periodicity (delay times between deliveries, peaks and troughs in demand), etc. When systems like this operate, they can give rise to complex behaviour and disruptions that can propagate up and down levels in unexpected and unpredictable ways.

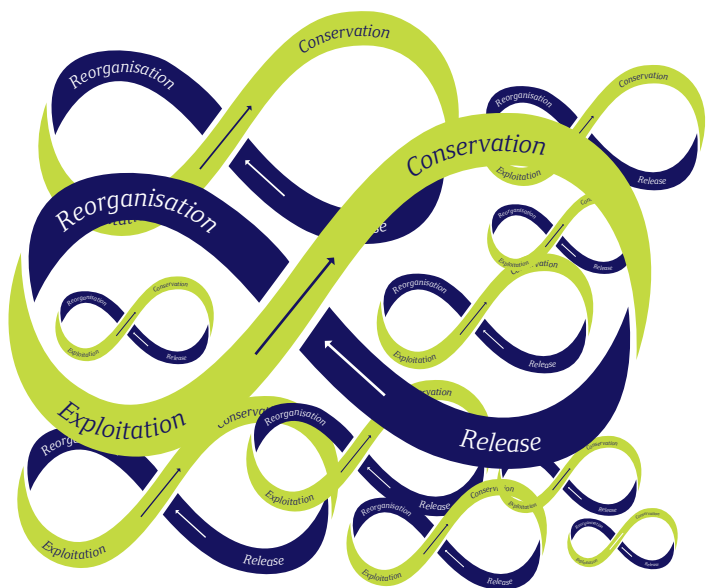


Figure 4: Holling Cycle across scale

FAILING TO PREDICT ACROSS SCALE

The Artic National Wildlife Refuge (ANWR) in northern Alaska, is located immediately to the east of the Prudhoe Bay oil field. For decades, oil companies have lobbied congress for permission to drill in the ANWR, where oil reserves are known to exist under its large coastal plain.

The grounding of the Exxon Valdez, in 1989, placed a spotlight on the practices of the oil companies and resulted in tightening of environmental protection for sensitive areas.

BP went to considerable effort and cost to raise their environmental credentials, becoming the largest producer of solar panels and acknowledging the existence of climate change. At the same time, it instituted an aggressive new management strategy, devolving responsible to local managers and holding them accountable for cost and productivity metrics.

The trans-Alaskan pipeline, built in the early 1970's, was co-owned and mostly managed by BP. A miscalculation by engineers during the pipeline's construction resulted in corrosion rates being far higher than first estimated. A succession of BP appointed managers delayed necessary maintenance on the pipeline in pursuit of their cost objectives.

In 2000, George W Bush won the US election and, to the oil company's delight, pushed congress to open up the ANWR for drilling. Revenue from this was even included in the US budget. However, a series of oil spills related to the poorly maintained pipeline occurred at the same time, providing environmental lobbies with the evidence they needed to stop drilling in the ANWR. Efficiency at one level of scale led to losses at another.

Because the levels are connected, they too are subject to being framed in particular ways (the framing of a manufacturing process may look different to an engineer than to a HR professional and each may perceive different intrinsic processes) which in turn will shape its behaviour (maintenance downtimes for the engineer, fatigue to the HR specialist).

The idea of nested systems is, again, a metaphor. It does not specify where a decision-maker might usefully draw the boundary between one level and another. Drawing boundaries in more useful, rather than less helpful, places becomes fundamental to the good governance of such systems.

The prescription, often attributed to Milton Friedman³ and used by others as an argument to privilege the interests of shareholders over other stakeholders, is an interesting case in point. This distinction was (and remains) attractive, as it provides a simple and tangible boundary condition. Put simply, either an individual or group holds shares or they do not. But is simple always the best in this context? The Chairs we interviewed advocated a broader stakeholder view when it came to their governance focus, a view not limited to shareholders. In other words, they were very conscious of their obligations and duties to a wide range of organisational stakeholders, with many emphasising the importance of this aspect of governance.

[Chair 64]: ...they are all relevant, because they all get encapsulated in the concept of licence to operate... Now you can lose your licence to operate by your shareholders voting and walking away, selling your stock... Or you can lose it by the bank saying, "We've lost confidence in your ability to keep on paying your debt, so we're going to close you down." You can lose it by the EPA,

³ This is traced back to his 1970 New York Times Magazine article, titled 'The Social Responsibility of Business is to Increase its Profits' (<http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>)

closing down [parts of an operation]. You can lose your licence to operate when society says what you're doing is bad. You can lose your licence to operate if you don't innovate effectively...

Recognition of the importance of all (or at least a wide range of) stakeholders does create a more difficult boundary-setting problem — who qualifies as a stakeholder? The definitive statement of stakeholder is generally considered to be that of Freeman '... a stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the organization's objectives' (1984: 46). This is a broad and highly inclusive definition. Deciding who is 'in' and who is 'out' becomes highly problematic.

"...boundaries define both, in a coherent way, what issues are to be included or excluded and who is to be involved in dealing with these issues"
(Midgley, 2003: 89)

Where these boundaries are drawn will regularly be a function of the assumptions held by board members, of which they are often unaware, making it difficult to assess the implications of drawing them as they do. For this reason, noticing where the boundaries have been drawn becomes necessary in order to explore the consequences of decisions. Significantly, the attributes the Chairs identified as associated with effective boards are those that provide the means for dealing with these types of decision challenges and identifying who or what should be included in the boundaries. Indeed, most of the Chairs rejected passive orientations to governance (such as compliance) as well as narrow conceptions of their role, describing governance as a means for reflecting, noticing, considering, adapting and creating. These reflect a view of governance as a cognitive activity but, importantly, this cognition is collective as well as individual.

Prediction

If good governance is to a substantial degree about how we deal with uncertainty and ambiguity, then our capacity to predict under these conditions becomes a core competence. Unfortunately, humans are particularly poor at making predictions, particularly where the casual relationships driving the situation are unclear. As Silver observes:

"We focus on those signals that tell a story about the world as we would like it to be, not how it really is. We ignore the risks that are hardest to measure, even when they pose the greatest threats to our well-being. We make approximations and assumptions about the world that are much cruder than we realise. We abhor uncertainty, even when it is an irreducible part of the problem we are trying to solve"

Silver, 2012; 20

The most reliable forecasts have been associated with approaches that incorporate ideas from different disciplines, pursue multiple approaches at the same time, rely more on observation than theory and a willingness to continuously reflect on and adjust the approach on the basis of new evidence.

In the context of governance, the prediction challenge covers a range of problems including predictions about potential changes to the external environment of the organisation; predictions about the impact of decisions taken in relation to one level of scale, on operations at another level of scale; and the need to make these predictions with both incomplete and often conflicting information, leading to diverse yet equally plausible expectations.

Section 4.0 will explore in more detail the way the Chairs characterised good governance in the face of these challenges and the attributes that were necessary in order to manage their impact.

4.0 | Governance is a team activity

“...despite the increased focus on corporate boards and the resulting upsurge of empirical studies in the area, there is still hardly any conclusive evidence on what determines a board’s effectiveness and how this in turn is related to firm performance (e.g. ROI, revenue growth, market share, CSR)”

Vandewaerde, Voordeckers, Lambrechts, and Bammens, 2011: 403

By speaking to the Chairs, one theme emerged more strongly than any other in terms of its impact on ‘good’ governance. Good governance is a team activity. The quality of the team is a ‘soft factor’, for which there are no readily available measures. As a consequence, this variable never appears in the economic and econometric analysis of the relationship between governance and performance. For the Chairs, however, this variable always emerged as one, if not the most, important factor supporting good governance.

For the Chairs, the quality of the team, typically viewed as the board and executive team, rather than the board itself, was fundamental to the governance process and the quality of decision-making. Indeed, contrary to the stance suggested by agency theory, the Chairs more generally talked of the need for a high level of trust and collaboration between the board and the executive. Where trust could not be relied upon, this was seen as a signal of the need to change management or to deal with board behaviour. The monitoring and oversight role, which is at the forefront of many approaches thinking about the

role of the board, ran a poor second to the need for a collaborative and supportive relationship.

As one Chair noted:

[Chair 34]: ...a really important aspect is actually the right relationship between the board and the senior management. And that, at its simplest, has two aspects to it. The first is supervision, under the old teacher/pupil type of...role. That’s probably 20 per cent of it or probably only 5 per cent of it, actually. And ... because the buck stops with the board there has to be that supervision aspect to it. But then there’s the other 80 per cent or 90 per cent or 95 per cent, which is actually ... you know it’s the mentoring; ... it’s the guiding.

Indeed, this suggests a view that a significant element of the board’s role is to act as a reflective capacity for the executive. The roles of the CEO and their direct reports often limit the ability for critical self-reflection, simply because of the volume of decisions and the pressure to make them within a limited timeframe. Without the time for deeper reflection on the assumptions being made, the potential for blind spots and unwanted bias increases. If the role of the executive is one of problem prevention and solving, part of the board’s role is about problem finding (Nickerson, Yen, & Mahoney, 2011). The board, being less pressured by time and operational decision-making, has a greater capacity for this reflection.

In terms of ‘good’ governance, the development of this reflective capacity is crucial to addressing the challenges of

perspective, scale and prediction discussed in the previous section. These are, in effect, limitations of our biology that need to be overcome if high-quality decision-making is to be achieved. For the Chairs, the development of the team could be characterised through four broad themes:

- An independent mindset and associated willingness to question and challenge respectfully
- A diversity of skill and experience
- Openness to alternatives
- Trust

In each case, it was the way in which these factors were combined together that produced the outcome the Chairs associated with ‘good’ governance and, therefore, contributed to better performance. Each of these will be discussed in more detail.

4.1 Independence

The concept of independence was most commonly associated with an independent mind-set rather than the structural aspects of independence (separation of roles, ownership etc). While a lack of structural independence was seen as an issue with respect to executive representation on the board; owner representation in for-profit organisations; founder or stakeholder representatives in not-for-profits; or the ‘Minister’s pick’ on Government boards, these were seen as secondary to the possession of a personal capacity to stand back from narrow self-interest and consider what was best for the organisation.

[Chair 47]: It’s independent mindedness, and that’s the only meaningful type of independence. You know, there’s a ... sort of independence, where you don’t own the shares, or you weren’t the auditor last week... But that’s all sort of nonsense ... people love having rules like that, but it’s all nonsense, because the only thing that counts is independent mindedness.

These findings are consistent with other research involving interviews with directors (see for example Letendre, 2004: 103). This independent mindedness was typically linked to the need for a robust exchange of views, which was considered more likely where individual members had a strong sense of their own agency and viewpoint, but were at the same time open to alternatives — not so deeply invested in their personal position that they could not hear others’ views and remain open to alternative perspectives. The need to bring alternative viewpoints to the table and into constructive tension through the open and frank exploration of views was present in discussions related to all phases of the Holling Cycle. These characteristics of group dynamics were, however, difficult to attain and sustain.

[Chair 48]: So as an individual board member, I have a fundamental responsibility to think for myself, make my own decision, and voice that in the board. But I’ve also got a collegiate responsibility to help the board produce the best possible response that it can.

This requires egos, personal agendas and interests to be set aside. Managing these requires a focus on very human qualities. It has implications for who is selected (personality attributes as well as experience) as well as an openness and curiosity to ‘get to the bottom’ of issues.

“If the role of the executive is one of problem prevention and solving, part of the board’s role is about problem finding

(Nickerson, Yen, & Mahoney, 2011).”

It also requires clear leadership on the part of the Chair (as a first among equals rather than as controller). Good processes and good structures will feature, but were seen as secondary to the softer factors described above.

This view of independence is quite distinct from the ‘structural’ way in which the concept is usually discussed in a governance context and, indeed, responded to in a policy sense. Independence interpreted in a purely structural way — having board members with little direct interest in the company or sometimes industry in order to be truly arms length from it — was seen as problematic if it was at the cost of understanding the business and its context.

Interviewer: So is your view that increased independence is a good thing?

[Chair 46]: ...I agree with that, although... you’ve got to balance that...if you’re so independent you know absolutely nothing about the company or the industry or whatever, you may not add any value. So it’s getting people who are free of conflict, but also have deep experience in the sector, and so the judgements are worthwhile.

As such, where independence in the structural sense reduces the quality of the team, arguably performance is impaired. This explains a number of studies that have found no relationship between independence and performance. For example du Plessis notes:

“ Evidence from both Enron and WorldCom further downplays the effectiveness of director independence in the context of ‘good’ governance. These companies already met the test for director independence (Sayles & Smith, 2006; Schwartz et al., 2005). For example, Enron’s board was loaded with luminary directors, including Dr. Robert Jaedicke, a former Dean of the Stanford Business School and accounting professor, along with several other respectable outsiders. This board was voted by Chief Executive

Magazine in 2000 to have one of the five best boards in the US, based largely on the reputation and independent status of its members.”

2008: 782

Similarly Swan and Forsberg found

“...that director independence had no effect on improving firm performance”

Bhagat & Bolton, 2009; Swan & Forsberg, 2014

However, these studies tend not to account for, or ignore, the deeper attitudinal (and admittedly more difficult to measure) aspects of independence that the Chairs point to as critical. People who felt that they were there to represent constituencies, which is clearly the case on representative boards, may be structurally independent, but were not necessarily independent of mind. This worked against the general ideal of creating an effective team.

Interviewer: I’ll put a hypothesis to you and you can tell me I’m wrong — but if you’re trying to build a team, it would seem to me that a representative board is not the best way to do it?

[Chair 23]: Oh it’s a disaster...I’d be surprised to hear of an organisation that has a representative board where people deem it an enormous success.

Indeed, numerous Chairs had a generally negative view of representative boards as an effective governance mechanism as, whilst they may bring a variety of perspectives, it was a fairly narrow version of what this variety should involve.

[Chair 99]: ...good governance comes when you get the right people on the board. So thinking through that structure of your board, the diversity factors and so on; diversity is much more than just about gender, it’s much more about skill sets and so on. So I’ve become a big fan of skills based boards, I think in some sectors the old representative board is far too prevalent.

So building on the theme of the board providing the reflective capacity for the executive, the concept of independence is still important in providing an arms-length position with respect to the executive operation of the organisation. Not only does this maintain the monitoring stance advocated by agency theory, it also provides the necessary space to think about the organisation's environment in a broader way less hindered by the constraints of delivering on KPIs and the relentless need to get things done. Du Plessis again argues:

“ that the boardroom should become a place where the issues central to corporate performance are discussed at depth and where the selection of agenda items are set by a vigilant and curious independent board”

2008: 785

In the examples of serious wrong doing, what companies like Enron had by way of structural independence they clearly lacked in independence of mind (Stein, Building, & Le, 2011). Independence should be more a state of mind than just a set of formal or legalistic arrangements. In the broader context of governance, it is this state of mind that contributes to performance.

4.2 Diversity of expertise and skill sets

The capacity of the board and executive (as a team) to be alert to environmental threats and opportunities, as well as internal risks such as those posed by management malfeasance, was strongly associated with the ability to bring a diversity of perspective to understanding the situation. For the Chairs, it was not demographic diversity that was valued in and of itself, but the diversity of skill and experience that may be associated with it. This is consistent with other research where, for example, Horwitz (2007) found there was no contribution to performance from demographic diversity per-se, once task diversity had been accounted for. So, it is not who you are or where you come from so much as what you

bring as a result that is important.

This was not, however, about experts for experts' sake, but to build the capacity to think together from a wide variety of perspectives through open collaboration that could respond effectively to the environment in which the organisation was operating. For example

[Chair 98]: ...it's a big thing to get the sort of independence of thought around a board table. And one Director may have no hands on financial accounting experience, but may be a very good intuitive thinker, who can make seriously good contributions without necessarily being able to read a set of accounts. And then you've got the diversity of thought that women bring to a board table. And you've got your financial types. So I think it's...important.

Expertise that was associated with a tendency to think that one person 'knows best' about a particular matter was not necessarily helpful. For example:

[Chair 35]: ... You can be a superstar as an executive but that's not necessarily the skill you need at the board. Because...you cannot be a sole trader on a board...you need all of your colleagues around you to be asking...the right questions and challenging. It can't be just down to one person.

The combination of diversity of skill and experience, and a willingness to engage in robust debate (task conflict) were only seen as an asset if the quality of the relationships established were such that they avoided interpersonal conflict. Having the smartest people in their respective fields in the room was of no perceived value if they could not work as a team. Significantly, task conflict has been associated with better decision outcomes, but only in the absence of personal conflict — the latter being mediated by group trust (Simons & Peterson, 2000). This point will be discussed in more detail in section 4.4

As tasks increase in complexity, higher cognitive demands are placed upon the task-doer (Campbell 1988). Consequently, it becomes less likely that all of the necessary capabilities to lead the team to successful task fulfilment will reside in a sole person, which means that sharing leadership in such instances will result in increased task performance. (Vandewaerde et al., 2011: 411)

Diversity then was a resource, but one that could only be accessed in the presence of a set of interpersonal and relational qualities if it was to add value. Furthermore, diversity needed to blend with an independent mindset.

[Chair 29]: ...if you've got the complementary skills and you've got the enquiring mind, and people respect each other's views etcetera, I think that goes a long way to ensuring you're going to get a good performance out of the board.

Diversity extended beyond different areas of professional expertise to include different life experiences and these may have arisen from professional or private spheres. Gender and cultural diversity were all seen to add to the mix of perspectives and play a potentially valuable role. For this study we specifically oversampled the number of female chairs, with a view to identifying the nature and size of any differences in perspective. While the results were inconclusive in this case, there were a number of observations made by the Chairs with regard to this topic.

The role of gender diversity

[Chair 16]: I think there is a difference, but it's not overly significant. I mean women are as different amongst ourselves as we are to different men. Some women will be very, very focused on making sure that people are looked after, and they'll approach things in a softer, more caring way, but not all women are like that. So, I think ... we sometimes do come at issues from a slightly different angle, depending on the industry that you're in. I'm ... more of a fan of diversity more broadly than just gender. I would really like to see

more people from different backgrounds; different upbringings; different schooling — rather than just the female thing.

While gender balance was commonly advocated as building diversity of perspective on the board, at least in our data, there were few clear differences in terms of the approaches and attitudes described by the women when compared to men. There were, however, some suggestions that hinted at the nature of the difference in perspective that are worthy of further study:

[Chair 51]: ...often you find that the people focus is a bit stronger coming from the female side than it is from the male side, and that's a good thing, so that's a whole cultural fit. I subscribe to the view that that's the most important thing we do in this business; get the people right, and the business will be right as well.

[Chair 73]: ...and women...often think of... the impacts on people, and what are the people and the skills they see, those sort of sides. I find sometimes the males see the technical side.

Not unimportantly, one of these was a perceived lower susceptibility on the part of women to hubris and narcissism.

[Chair 44]: And the chance, frankly, and this is a very male thing, of becoming a megalomaniac, is big. And if you look back... at the tragedies of companies over the years, mostly there was a person there, or a couple of people, who went on a megalomaniac spree; got too big, decided they didn't need to talk to the board, borrowed too much money, thought they could run an industry that had nothing to do with them, etcetera. You take out megalomania you probably don't have too many crashes actually. You might not have much entrepreneurship either, but that's a different thing.

[Chair 51]: ...we always used to laugh, that if you have two people applying for the same job and one's male and one's female, the male will be certain he can do the job when he has 65 per cent of the skills, and the female will be certain she can do the job when she has 110 per cent of the skills.

This observation is important as excessive ego can shut down effective cooperation and team functioning. The Chairs argued for an environment where there was willingness to listen and debate without a view to scoring points or winning over others, but rather to get to a deeper understanding of the situation.

[Chair 10]: ...women are often more prepared to ask some tough questions, I think, just because we just want to sort something out. It's not that we're trying to be difficult. We just...you know, we just want to understand it and work out what the best solution is...men, I think, are more trained to be in a team and follow their leader and women are probably taught to be more problem solvers at a general level. This is gross generalisation, but anyway, I've seen it often.

The impact of tenure

Over time, and with familiarity, diversity of view on an established board can reduce, as it is argued that directors begin to converge in their thinking. This raises the issue of director tenure. The Chairs had a range of views on tenure and its impact on diversity. Some thought that there was a 'sweet spot' in terms of tenure, while others argued that, again, it was more an attitude of mind, and that the key issue was engagement. The following quotes unpack some of this thinking.

[Chair 51]: I think it took me five years, three to four years anyway, to really become proficient, certainly no expert, but able to have a conversation on the [X] industry. So that's why I say that it depends on the company and on the take of the Chairman. Generally I think three term

tenures is about right. I don't think one should be so black and white as to prejudice a company should there be circumstance that says it should be longer than that.

[Chair 52]: ...I think... nine years is about long enough. I think it takes six years to get to know it, you've got three years really hammering in there, and after nine you probably need to continue to refresh actually.

Whilst the above quotes tend to link a concern with the ability to contribute to a tenure or length of time, for others tenure was almost seen as irrelevant with 'attitude of mind' being more likely affected by other factors, such as a stage of career. Responses also varied depending on whether the Chair was talking at the level of the board or the individual director. Board renewal, and the need to balance skills and experience to achieve the best team, remained the most important thing, with external review one of the key tools to help achieve this. For listed companies regular internal and external review is mandatory. The experience of reviews was, however, somewhat mixed,:

[Chair 64]: I find so many boards have excuses for reviews, "Everything is going well now; we don't really need one." "We're in such trouble now, we don't really have time for one." "We've got new directors coming on board, it wouldn't make sense for one." "We've got a new Chief Executive who's just started, let's let him settle down." It's very easy to find reasons for not doing an independent review, good boards don't let themselves get caught in that but keep on doing the reviews, top to bottom, of the whole company.

The value or contribution of increased diversity also depended on the stage of the Holling Cycle the board was dealing with. During the relative stability of the Conservation phase this was primarily with knowing what

to look for to understand the relative performance of the company and to identify industry specific issues impacting on performance. However, also during this phase it was to remain sensitive to small signals that might suggest an approaching Release.

During Release, Reorganisation, and Exploitation, diversity of skill provided a deeper pool of expertise to draw on to capitalise on opportunities and manage risks. As the situation changes, different skills and perspectives come to the fore. Therefore, it makes sense that greater diversity within the team increases the board's ability to effectively deal with the different circumstances the organisation can face. This only works if members of the team are open to alternative perspectives from their own.

4.3 Openness to alternatives

The flipside of having diversity on a board is the need to be open to the alternative possibilities that can emerge as a result. This entails a level of cognitive adaptability on the part of individuals and a willingness to question, reflect, and consider alternative viewpoints.

[Chair 32]: ...Beyond that, it's the personal qualities and being able to operate in a collegiate process but independently thinking at the same time. You can be a very independent thinker who just wants to think your way and never, ever listen to what anybody else says, which is going to be pretty disruptive on a board. Or you can be the other way where you just accept everything that's said and don't think independently about an issue.

There has been ongoing debate about the extent to which an individual's decision orientation is influenced by their personality attributes, personal experiences, and preferences, as compared to the context in which they find themselves. A key contribution to understanding the relative influence of these variables is to be found in 'upper echelons theory'.

...the core of upper echelons theory, has two interconnected parts: (1) executives act on the basis of their personalized interpretations of the strategic situations they face, and (2) these personalized construals are a function of the executives' experiences, values, and personalities. As such, the theory is built on the premise of bounded rationality (Cyert & March, 1963; March & Simon, 1958) — the idea that informationally complex, uncertain situations are not objectively "knowable" but, rather, are merely interpretable (Mischel, 1977).

(Hambrick, 2007: 334)

These findings reinforce the Chairs' view that there is a key role for the Board in being able to consider alternatives and to use that to select, mentor, and support the executive; and that this becomes most critical in times of rapid change. Being open to alternative views, again, comes down to personality. While there is a rapidly growing literature on personality characteristics and the quality of decision-making, there are few clear findings (Abatecola, Mandarelli, & Poggesi, 2013). However, one particular personality type which is likely to be antagonistic to effective team collaboration, and which was identified by Chairs as a source of difficulty, is that of narcissism.

A growing number of studies have identified narcissism as a common personality trait of CEOs (Judge, LePine, and Rich, 2006; Chatterjee and Hambrick, 2007; Resick et al., 2009; Peterson, Galvin, and Lange, 2012) and the upper echelon literature has identified narcissism as a personality dimension of CEOs that influences their strategic decisions (Chatterjee and Hambrick, 2007, 2011; Gerstner et al., 2013). For the Chairs we interviewed it was not the narcissism of the CEO, however, that was always the problem. As a team, narcissism in any individual was problematic, but most likely to show itself in the relationship between the Chair and CEO, with either potentially being the problem.

[Chair 100]: I'm very frightened of hubris... 'cause I've seen it destroy too many things and you get too complacent and, you know, you're only as good as your last success, really.

Interviewer: Is it common?

[Chair 100]: I think it's very common... we're human beings.

Narcissistic individuals are described as:

...excessively confident about their intelligence and judgment, and to be arrogant, and disagreeable (Rhodewalt and Morf, 1998; Campbell and Miller, 2011). They also seek continuous affirmation of their inflated self-view by exhibiting their superiority, devaluing others, and reacting aggressively to criticism (Paulhus and Williams, 2002; Carlson, Vazire, and Oltmanns, 2011). (Zhu & Chen, 2014: 2

Whilst it can be argued that in some circumstances these attributes are necessary in the CEO role, they are the opposite of the attributes that allow for an openness to alternative views.

[Chair 44]: The Chairs that think they can do everything better tend to lose their boards, often lose their positions, but certainly lose their CEOs. It must be awful working for them.

To the extent that people with this characteristic continue to be attracted to the CEO role, or worse, carry these onto any board for which they may be selected, the ability to leverage the value of diversity, independence and provide a reflective capacity to the executive is reduced. As these attitudinal factors become very important in the selection process.

[Chair 21]: ...I'm...on a board at the moment, we're talking about new board members and people that are seen as opinionated — CEO's or,

you know, senior executive — they're just struck off the list straightaway, you know? It's like, "No, there's a style issue. No, we don't want to deal with them.

The three issues addressed so far (independence, diversity, and openness to alternatives) suggest the need for individuals with particular dispositions and skills but also have implications for the quality of the relationships that are formed. This leads to perhaps the most important of all of these attributes — trust.

4.4 Trust

The need for trust, respect and collegiality was a central feature of most of the discussions about board functioning; and was seen as essential to effective governance of the organisation. It was significant that in almost all cases this trust was seen as a requirement both within the board and between the board and the executive team.

[Chair 02]: ...so I think a board is a very good body in monitoring, watching, guiding, counselling the management of the company. And the most important element, I think, between the board and management needs to be one of trust and respect; between the board members, and between the board and the management. And if that is there, trust and respect...with appropriate corporate responsibility and values, then from that fundamental sharing of views will flow appropriate governance practices, which in my view will lead to a better performance, primarily driven by behavioural changes and cultural changes.

Surprisingly, trust has received relatively less attention in the decision-making literature compared to other process variables (McAllister, 1995). Most trust research has focused on the individual and, whilst an important level of analysis, the importance of team dynamics to good governance suggests a greater level of investigation into the role of trust

within teams, is required (Serva, Fuller, & Mayer, 2005).

Chowdhury (2005) has argued that intra-group trust can be useful in information sharing, while Simons and Peterson (2000) found that intra-group trust plays a critical role in the interpretation process. The ability to openly challenge others' perspectives without fear of ridicule or retribution (Olson & Parayitam, 2007: 197) goes to the heart of this process.

[Chair 35]: It's no good if the board is fighting with each other or there are power plays or politics going on at the board level. I think that it... doesn't mean that you need to be the same, but you need to understand where each other are coming from and respect each other's views and allow their views to be heard.

That the decision-making body of the organisation is separated into two sub-teams (the board and executive), arguably complicates the process, as trust has to

“ ...that having the requisite expertise; having the right information; and even having an independent mindset will not be enough if low levels of trust exist between members of the team.”

operate across multiple levels and therefore a far deeper understanding of this dynamic is required. Trust has been shown to have quite tangible effects on the quality of decision-making. Indeed, research conducted by Klein et al (Klein, Snowden, & Pin, 2007) clearly illustrated the reduced capacity of newly formed teams to detect and process weak signals from the environment, despite the fact that individual members of the teams had correctly identified the weak signals. In the absence of trust they were reluctant to flag their concerns, keeping their own counsel. This suggests that having the requisite expertise; having the right information; and even having an independent mindset will not be enough if low levels of trust exist between members of the team.

These observations present a number of paradoxes that need to be considered. It could be argued, for example, from a principal-agency theory point of view, that the function of boards is to reduce agency costs (Coase, 2007; Jensen & Meckling, 1976) resulting from the delegation of decision making to the executives, by exercising effective oversight.

Overall, the dominant perspective in prior research on CEO-board relations suggests that personal social ties and obligations between managers and directors critically impair a board's capacity to monitor and control management decision making and performance, thus diminishing effective board involvement (Westphal, 2010: 8-9)

Trust in this context implies risk of collusion — a shared mind — and this would seriously diminish the independence assumed to be necessary to ensure that the board can perform its oversight role. However, running counter to this is the argument that this control function is effectively undermined by information asymmetry. CEOs are more likely to disclose information and not seek to misrepresent situations in a context of trust rather than one of high stakes accountability (Westphal, 2010: 11). As one

Chair observed in relation to the characteristics of ‘good’ governance compared to simply effective governance:

[Chair 93]: ...what do I mean by good governance? I mean a healthy relationship around the board in terms of approach to decision-making; a healthy relationship between board and management so there’s transparency of information flow; and respect; and trust; and a good crisp dialogue that takes place — will allow effective decision-making at times when the unexpected happens and decisions have to be made and strategic plans have to be turned around or reshaped quite quickly.

The Chairs, moreover, appear to see the oversight role as contingent in that, to the degree that management identify with the organisation and have values and interests aligned with it (as advocates of Stewardship theory (Caldwell, Hayes, Bernal, & Karri, 2008) would argue), they can be trusted to act for the company. Indeed, creating a climate which signals a lack of trust has been shown to diminish the desire to extend trust (Roberts, 2001).

Some may also argue that too much trust leads to group-think and the associated reduction in the quality of decision-making this suggests. This raises the importance of the other capabilities (diversity of skills, independent mindset and openness to alternatives). The Chairs in our sample were not advocating any particular one of these capabilities, but all of them in concert. Diversity and the creation of an environment where different ideas can come into constructive conflict is an antidote to group-think. Not kept in balance, group-think may emerge. Migliore et al state, for example, that:

“Demographically similar boards of directors can advance in-group cohesion and enhance trust among individual board members. However, it can also lead to the phenomenon of group-think, where individuals cede to the consensus in order to be a part of the group.” (Branson,

2007; Khurana, 2002; Ramirez, 2003, which has been attributed to political and business failures (Branson, 2007).

(Migliore & Horton DeClouette, 2011: 323)

Furthermore the concern of the Chairs is how to manage complexity. This cognitive challenge is not well supported by compartmentalising responsibilities, systematization of processes or the establishment of a set of standard measures of accountability. Indeed, trust has been identified in a number of strands of the decision literature to be the key lubricant that enables an organisation to harness the value of diversity in responding to the complexity associated with uncertain environments.

Trust, then, appears to be the unlikely secret ingredient to addressing the problems that arise from reflexivity and the collective misconstrual of the environment. It therefore goes to the heart of what constitutes ‘good’ governance.

5.0 | Board capability and its relationship to context

Thus far we have argued, based on the views received by the Chairs, that in order to understand the relationship between good governance and performance, we first need to understand the way in which the challenge of good governance changes depending on different circumstances.

The Chairs themselves did not explicitly discuss how the skills, relationships and structuring of the Board needed to be different in relation to changing contexts. However in their stories, they did describe the way in which the attributes discussed in the previous section played out, or contributed to, effective governance and/or performance in a range of situations. In this section we will use the Holling cycle as a metaphor to consider the types of capabilities required and the likely impact of different levels of board functioning during different phases.

“ Good governance implies recognising different levels of uncertainty in situations.”

A considerable body of research on decision-making has developed over the last century. Across a range of fields this work has examined the characteristics of decision-making under different conditions. For our purposes, however, the Sense-making framework developed by Kurtz and Snowden

(2003) provides a useful integrating model with which we can begin to explore this question. The Sense-making framework is useful here for a number of reasons:

1. It describes different problematic circumstances in terms of the levels of uncertainty inherent in them, much like the Holling Cycle;
2. It aligns different decision-making modes to different levels of uncertainty.

Therefore, by layering Kurtz and Snowden’s sense-making framework onto the Holling Cycle, the possibility exists to test the different decision-making modes appropriate to each stage of the Cycle. We are not the first to observe the compatibility of the Sense-making framework with the Holling Cycle. Noah Raford (2009)⁴, at the London School of Economics, proposed the following alignment of the four phases with Kurtz and Snowden’s framework. (See figure 6).

It is important to note that whilst the Sense-making framework intuitively makes sense, it has not been tested empirically. So again, taking the 411 vignettes collected through the interviews as the primary data set, we coded the vignettes for the decision-making sequences identified by Kurtz and Snowden to see whether they match the associations identified in the stories the Chairs described. The results of this analysis are presented here as an empirical check on the legitimacy of approaching governance during different levels of environmental uncertainty using these combined lenses.

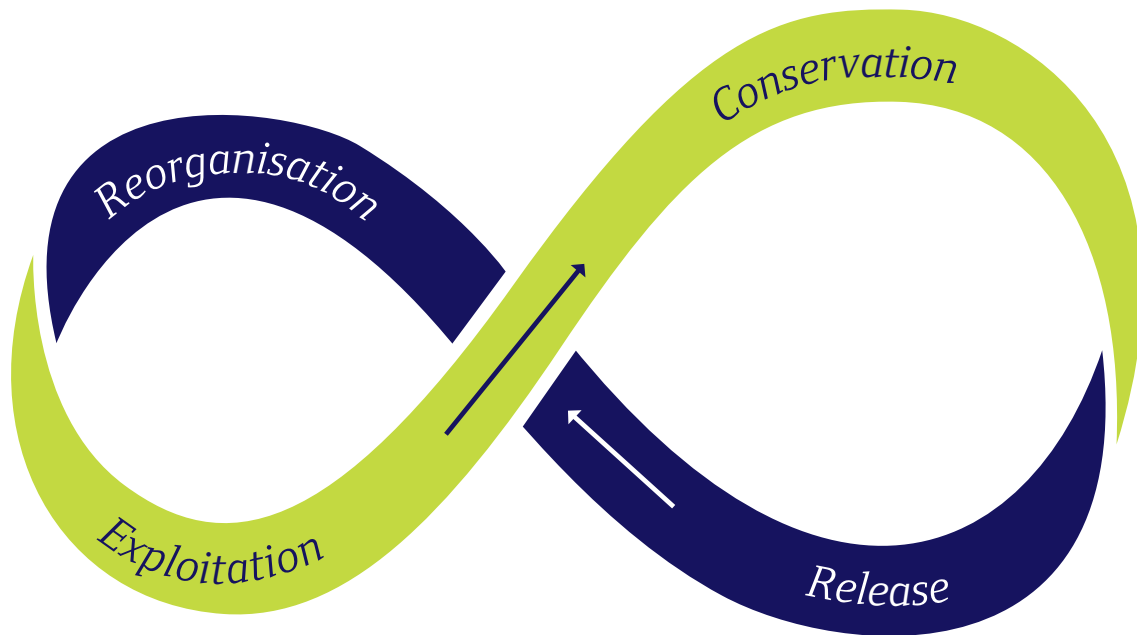
⁴ www.youtube.com/watch?v=-bJp_OSoyQ

Situation is **Complex**

Cause & effect associated with decisions is 'Known in retrospect'
Recommended decision pattern is: Probe-Sense-Analyse

Situation is **Known**

Cause & effect associated with decisions is 'Known'
Recommended decision pattern is: Sense-Categorise-Respond



Situation is **Complicated**

Cause & effect associated with decisions is 'Knowable'
Recommended decision pattern is: Sense-Analyse-Respond

Situation is **Chaotic**

Cause & effect associated with decisions is 'Unknown'
Recommended decision pattern is: Act-Sense-Respond

Figure 6: Combined Holling Cycle and Sense-making Framework

5.1 Patterns of decision-making during Conservation

The Conservation phase is characterised by a relatively low level of uncertainty. This is due to: the relative stability of the environment; the existence of tried and tested processes and routines; and delivering to well-established and understood markets. During this phase, in the for-profit sector, performance will be primarily concerned with indicators of quality of service, customer satisfaction, staff satisfaction and financial performance. For the not-for-profit and government sectors the stage would be characterised by the execution of process linked

to established policy problems or strategic priorities where there is a well understood set of relationships between the delivery of outputs and the intended impact on the targeted beneficiaries. These characteristics most closely align with the 'Known' quadrant of Kurtz and Snowden's framework.

Preferred decision style

Kurtz and Snowden recommend a Sense-Categorise style of decision-making during this circumstance. Issues or problems that arise will typically have a well understood and 'off-the-shelf' or 'best practice' solution. Analysis of the interviews revealed that the chairs also strongly advocated this approach in relation to their Conservation phase stories. However, illustrated in Figure 7, there was also advocacy for sense-analyse and probe-sense. How is this to be understood?

THE TRAP OF AN INCREMENTAL CRISIS

Chair [77] related the story of a friend whose company had gone out of business. The Chair asked the friend how this happened, the friend replied: “Very slowly and then very quickly”.

This is typical of a mismanagement of the Conservation phase. The stability of the Conservation phase can often lead to the faulty perception that all is well, while in the background, key elements of the environment are changing, bringing the inevitable Release ever closer.

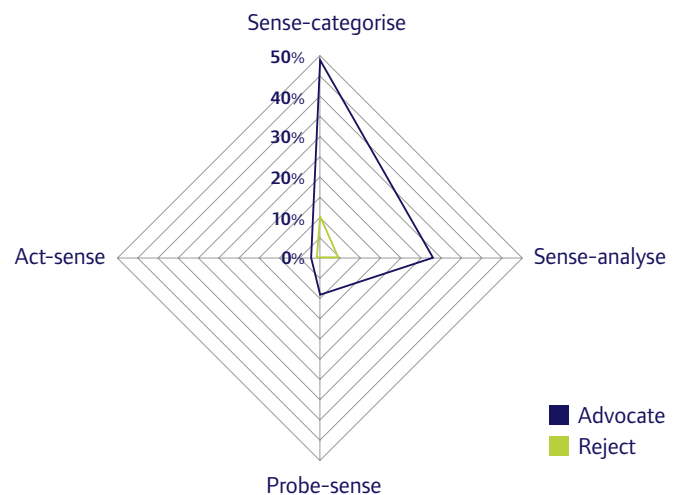
The assumption of stability leads many organisations to pursue ever greater efficiencies from their current business models at the expense of exploring new ones that will help it survive the Release, and prosper into a new cycle.

Description for four Decision-making styles

- 1 **Sense –categorise:** Use where dealing with previously encountered situations for which there exist known good solutions. Assess the issue, categorize it by type and select the ‘best practice’ response.
- 2 **Sense-analyse:** Use where dealing with a complicated problem which is not currently understood, but it can be. Analyze the problem (frequently by drawing on external domain experts) in order to arrive at a considered response.
- 3 **Probe-sense:** Use where dealing with complex, multi-dimensional problems which are novel. Look for patterns. These may not become apparent until some action is taken and the response observed. Make small, incremental and experimental investments, learning from the results.
- 4 **Act-sense:** Use where dealing with a chaotic situation with little or no apparent pattern. Act decisively to address the most pressing issues. This may shape what is occurring, albeit with a high risk of unintended consequence. Subsequent responses are directed at amplifying the desired pattern and suppressing the less desirable.

The Conservation phase involves an increase in the number of interdependencies between factors in the production process (including those in the supply chain and distribution processes). With the increase in interdependencies comes an associated increase in fragility — a failure in any one of the connected parts could contribute to an overall failure. This is amplified by the removal of organisational flexibility. This phase, therefore, represents a deep organisational commitment to the supply of particular goods or services to particular market segments. This includes sunk costs in productive assets and systems, and the organisational culture. Many of the actions taken to improve performance in this phase further deepen this fragility and limit the organisation’s capacity to respond to unforeseen situations.

Figure 7: Decision-making profile for



Conservation Phase

That the Conservation phase is characterised by gradually reducing resilience is a key concept in the Holling Cycle, as it is this factor that makes the Release phase inevitable. Accepting this idea, it is fundamental that the board is alert to, and actively searching for, weak signals of a phase

change. The proportions to which the Probe-sense and Sense-analyse profiles are present is representative of that activity. Arguably a board that only displayed a Sense-categorise decision-making profile during the Conservation phase, would be ill-prepared for a change in circumstance.

5.2 Patterns of decision-making during Release

The Release phase is characterised by the collapse, or rapid reduction in the importance, of the mode of operating during the preceding Conservation phase. This leads to a rapid increase in uncertainty. The key performance concern during this phase is with survival, in extreme cases, and maintaining sufficient reserves to be a player in the Reorganisation phase (although the foundations for survival will have largely been determined by what was done during the preceding Conservation phase). Effective prediction, for example, may have allowed for some influence over the timing of the release with the potential to minimise the downside and maximise the opportunity it presented. Other key aspects of performance here will be the capacity to learn and adapt. Managing the perception of stakeholders will also likely be important. At the same time, during such a phase, the risk of opportunism increases, meaning that the Board has a role to prevent self-interested action which may operate at the expense of the company — this will include various forms of white collar 'looting' including fraud and theft. Monitoring for conformance with legal and ethical principles will therefore also loom large.

Preferred decision style

The Release phase of the Holling cycle will typically be chaotic — replete with unknown-unknowns. The least appropriate decision stance here would be that of Sense-categorise-respond. In principle, the most legitimate would be Act-sense-respond. Figure 8 shows that while there were many instances of respondents rejecting Sense-categorise, and a relatively high proportion advocating Act-sense, there were advocates for Sense-analyse and for Sense-categorise within the respondents' stories.

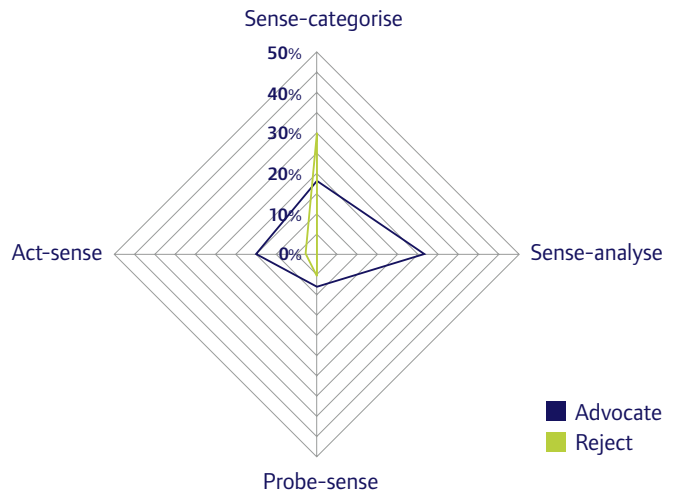


Figure 8: Decision-making during the Release Phase

The unexpectedly high level of Sense-categorise is worth further discussion. Upon closer scrutiny of those stories, it became apparent they took two forms:

- A specific pre-determined action or process step, e.g. application of a business continuity framework; or
- The application of a principle (a class of response).

These principles included ethical boundaries and rules of thumb and were not, therefore, as prescriptive as implied in the usual Sense-categorise decision orientation.

Whilst both of these responses appeared to be based on either planning for, or experience of, a Release, they also appeared to limit the potential range of responses the board would consider. This could be viewed two ways: (1) limiting choice, makes the decision-making process easier and, therefore, would have advantages in terms of speed of response. (2) it leads the board and executive to adopt a particular response path prematurely.

According to the theory, the high level of advocacy for Sense-analyse may be misplaced, as the board interprets

the situation as one where analysis is the best path to an answer. This is a reasonable interpretation, as chaotic environments are not generally well-handled by management theories. It is also the case that complex and chaotic situations often present themselves in similar ways. Some may also argue that it is better to err on the side of assuming some possibility for prediction rather than surrender to chaos prematurely.

5.3 Patterns of decision making during Reorganisation

The Reorganisation phase is characterised by a rapid reconfiguration of the business environment. While this will present many opportunities, it will also likely be the case that hard and soft assets built during the prior Conservation phase will not be appropriate for capitalising on those opportunities. This Phase, therefore, favours the new entrant. This will be a time to take hard decisions about what assets to retain, divest or acquire, and on the appropriateness of the executive team to the likely challenges to be faced — not only during the Reorganisation phase but also the subsequent Exploitation phase.

Performance during this phase will be supported by the organisation's capacity to innovate new business models as well as assemble partnerships and networks to carve out distinctive opportunities. This period can again be subject to opportunistic behaviours, in this case more directed at 'ends justifying means', with a heightened risk of unethical conduct. The preceding Release phase will likely mean that normative and cultural patterns, along with the ethical checks and balances that had been established during the previous Conservation phase, will have dissipated and need reinforcing; or the substitution of monitored principles of conduct.

It is also important to note that this is the phase that is least represented in the sample (as expected) and, as a consequence, lacks the same richness of data that is available for some of the other phases.

Preferred decision style

The Reorganisation phase is characterised by the presence of new entrants and the need to reapply and reconfigure resources in response to what will appear as a vague and highly changeable environment. These investments themselves may help to identify the nature and form of opportunities available to the organisation. Alternatively, they may generate unintended consequences. In this regard Probe-sense-analyse is the most logical response, and is recommended by Kurtz and Snowden. Probe allows an organisation to dip a metaphorical toe in the water, while not requiring large pre-commitments of time or resources. They may take the form of product trials or investments in start-up firms that reserve the right to play as the market evolves.

Checking this against what the Chairs had to say in their Reorganisation stories (Figure 9), we see the greatest divergence from theory of any of the phases. Advocacy for Probe-sense-analysis was present to a moderate degree. However, no more than Sense-analyse, and only marginally more than Act-sense. This could be seen in two ways: (1) the theory is wrong; or, (2) knowledge of innovation, as a process, is relatively lower than knowledge of the organisational processes typical to the other phases of the Holling Cycle. In reality, it is probably a combination of the two. The degree to which Act-sense was advocated suggests an assumption that innovation is unpredictable and therefore there is no point trying to analysis it; it is more about 'having a go' to see what happens.

The rejection of Sense-categorise is what would be expected. Overall, however, there was still a high level of advocacy for Sense-categorise. The Sense-categorise responses in this Phase often appeared to represent an attempt to impose order, or to return to BAU as quickly as possible after a disruption. This is predicated on the assumption that the modes of operation associated with the previous Conservation phase may still be tenable. This may reflect the belief, typical within economic theory, that there is a single stable equilibrium to which a system

Without an effective team, the ability to align the decision-making approach to circumstance will be reduced, with the quality of governance suffering as a result.

will typically return after an external disruption. To the extent that the wider market or economy has returned to the same pattern, re-imposing processes and frameworks that had proven workable prior to the disruption may have some legitimacy. Having the system return to a pattern similar to that which existed is a possibility; or it may take time to come to understand if, and in what way, it is different. There is currently a lively debate, for example, as to whether the global economy has returned to its pre-GFC state or moved to an entirely new state (Galbraith, 2014; King, Stephen, 2013).

5.4 Patterns of decision-making during Exploitation

During the Exploitation phase strategy becomes critical. This is the stage when new opportunities are beginning to crystallise. The formation of alliances and establishment of joint ventures may feature prominently; and while the Reorganisation period may have been dominated by experimentation and innovation, this stage will require commitment to a particular course of action — with attendant investments of capital — that will define the organisation for the foreseeable future. As with any innovation process, a ‘fail fast’ approach will be needed and the board should be placed to help make difficult decisions, including to support management in recognising that ideas in which they have invested time and effort have too little potential and need to be abandoned. Diversity of experience in very different types of business will increase the capacity to see new opportunities and exploit them. In addition to financial investment, this stage will also require the rebuilding of the organisational culture and the establishment of a way of working appropriate to the emerging environment.

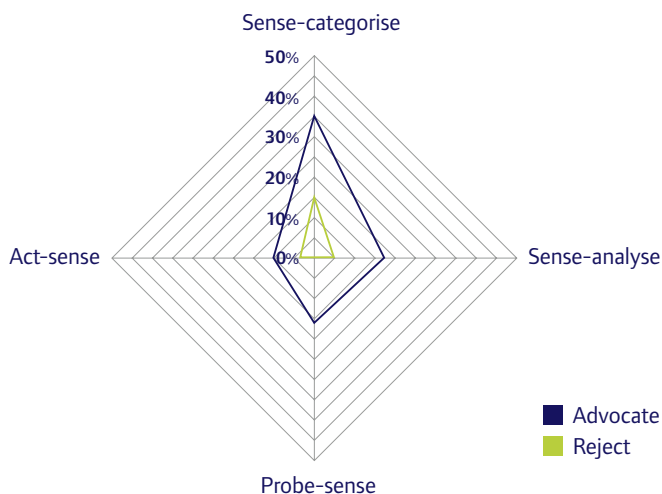


Figure 9: Patterns of decision-making during Reorganisation

Preferred decision style

The Exploitation phase is characterised by emerging and tightening patterns. This is the domain of the known unknowns, with Kurtz and Snowden advocating Sense-analyse as the preferred decision-making profile. It is also the dominant pattern present in the stories told by the Chairs during this phase. There is some advocacy of Probe-sense. This is arguably appropriate as there is still uncertainty in the environment and the use of small experiments is still valuable. Similarly, as the Exploitation

phase leads into the Conservation phase, the level of predictability is increasing and supports a degree of Sense-categorise. In short, there is a high level of compatibility between the theory and what was found in the interviews.

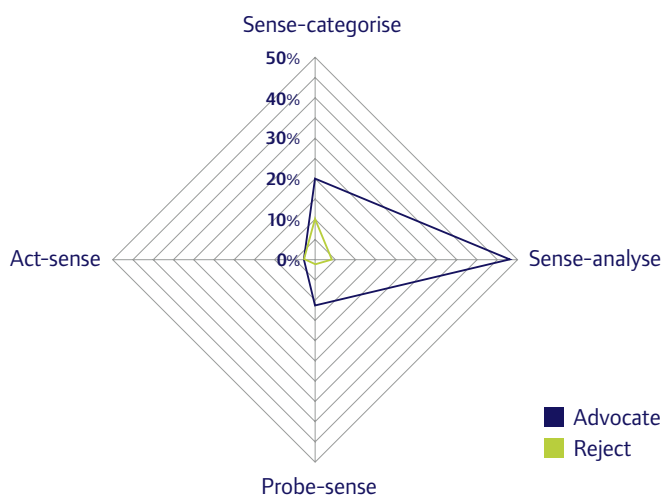


Figure 10: Patterns of decision-making during Exploitation

5.5 Implications

There are two key implications to draw from the analysis in this section. The first is that the dynamics associated with the challenge of governance under different circumstances vary, and vary considerably. The second is that, generally, the patterns of decision-making displayed in the stories told by the Chairs that reflect these different circumstances were consistent to those proposed by theory.

That said, the stories collected for this study were arguably the more extreme circumstances (for better or worse). Many of the Chairs suggested there was a ‘sweet spot’, where the dynamic of the team was performing well and reflecting the attributes identified. They also suggested this ‘sweet spot’ may be quite rare, but we don’t know how rare. So whilst, as an average, the decision-making profiles

presented in this sample suggest a high level of decision-making capacity, it is likely these results are representative of the ideal circumstance rather than the norm.

The Chairs we interviewed were generally very experienced. Recognition of the need to vary decision style by context — while reflected here at the tacit level and in aggregate — does not tell us how well or how often these decision stances are occurring in relation to individual decisions taken by individual boards, and certainly not by the extended decision making team involving the executive. The capacity to recognise, categorise and respond appropriately may be quite varied among boards. We do not know how widely understood the need for these attributes or this orientation is in practice; nor how this tacit knowledge is developed, over what time periods and under what conditions.

These findings further emphasise the importance of the role of the Chair as facilitator and their ability to nurture alternative views; engender trust; and increase the coherence of the extended team. To the extent that the attributes of directors are associated with personality types and dispositions, they may be difficult to identify during selection processes. Poor selection can have dire implications for the development of these attributes in the team. This may explain why some preferred to use personal networks when canvassing new board members. Past experience of working with a person reduces the risk of selecting someone without the needed attributes. Unfortunately this also carries the risk of narrowing the pool from which directors are selected, contributing to the perception that it is an exclusive and closed club and limiting the ability to increase diversity in perspective.

Without an effective team, the ability to align the decision-making approach to circumstance will be reduced, with the quality of governance suffering as a result.

6.0 | Summary and conclusions

Attempting to quantify the relationship between ‘good’ governance and performance is a difficult pursuit due to the vast range of potential variables involved and the value-laden nature of the question itself. In this research we have sought to provide greater depth to this question by exploring the assumptions inherent to it. What does ‘good’ mean? And what is the nature of performance? Furthermore, does this change from context to context?

In truth, this report has only scratched the surface of dealing with these issues. However, it does provide important pointers to where the answers may lie. As noted throughout the report, our goal was less focused on providing a simple yes or no answer, and directed more towards identifying the factors that contribute to the relationship between governance and performance. Indeed, the literature on the topic has, for a range of reasons, struggled to come to grips with the nature of the relationship. Perhaps of more significance to current debates on corporate governance is that this study presents the views of those involved — directors — rather than proxy measures of what might count. As a consequence, the findings are concerned with what directors actually think about governance and the concerns they deal with, and not with assumptions. Their input led the research in a quite different direction, particularly with regard to defining the notion of ‘good’.

For the Chairs, ‘good’ governance is a team activity, and the team includes the board and the executive. This is in stark contrast to the agency-based models that have informed much of the debate about governance to date, and indeed the formulation of regulation. It does not

deny the important role of monitoring and compliance, but distinguishes these activities from a broader, more comprehensive notion of what ‘good’ governance is. It also shifts the focus of attention when we come to consider implications for, and supporting improvements to, practice.

Viewed as a decision-making unit, the board provides the reflective capacity, often difficult to maintain in an executive role, by supporting higher-level sense making about the organisation’s environment and the quality of decision-making overall. Good governance then, is more than just risk management. It involves accepting, dealing with and capturing value from uncertainty. It also changes, depending on the context.

The Holling Cycle was introduced as an explanatory heuristic for this study. Our purpose for its introduction was to illustrate the range of challenges faced by the decision-making body of the organisation as it attempts to navigate its way through the different types and degrees of uncertainty. The study showed that, at an intuitive level, the Chairs implicitly understood what this involved, with the decision-making patterns they displayed in their stories reflecting changing circumstances. Moreover these patterns were broadly consistent with the findings of research from the decision-making literature. What was also evidenced through the interviews was a recognition that achieving this sensitivity to uncertainty could only be done as a team.

Building and maintaining the right type of team is difficult, with many Chairs indicating a ‘sweet spot’ where the many variables involved came together to produce an effective decision-making unit. They also recognised that this was

difficult to maintain over time and, whilst the need for skilled, experienced directors coupled with increased diversity on boards is well documented, it was no guarantee of 'good' governance. What has been emphasised here is that — more important than just different skills and diversity of perspective — is the creation of trust between members of the board and the executive. The power of bringing alternative perspectives to deal with problems and to capturing opportunities in an authentic and respectful way will not occur in an environment of distrust. Independence of mindset (as opposed to the structural factors regularly discussed) was key, but inaccessible without trust. This presents some significant measurement issues if we are to get closer to understanding the relationship between 'good' governance and performance. They are measurement issues that cannot be ignored, however, if we are to explore this question in a way that reflects the lived experience of directors and, consequently, has relevance to practice.

A greater challenge exists when we turn our attention to what constitutes performance. Put simply, whose view of performance are we concerned with? The overwhelming focus on the shareholder that pervades the literature does not reflect the views presented by the Chairs in our sample. The nature and needs of the shareholder change considerably between sectors and the relationship the shareholder has with the organisation. Performance, seen through the eyes of a diffuse, often disengaged, shareholder base (like that of many publically listed companies) is vastly different to the single, highly engaged shareholder that public sector organisations respond to. Furthermore, are we talking about 'outputs' or 'outcomes'? For the public and not-for-profit sectors, traditional financial measures of performance are important for operational reasons, but often irrelevant to their reason for being. There is limited value in a sound balance sheet if the stakeholders the organisation is supposed to help are left starving in the street.

The Chairs were overwhelmingly concerned with the views of a wide range of stakeholders in their considerations of governance. Not because they had a direct impact on

the financial measures of performance, but because they impacted the broader resilience of the organisation and the ongoing achievement of strategic objectives. Understanding the complex relationship between shareholding; the perception of outcomes; the definition of strategic objectives; and engagement between the shareholder and the organisation is an area that requires considerably more research and consideration if we are to identify a more comprehensive notion of performance. It also suggests measures that are highly sensitive to the context. Does this mean it will not be possible to compare organisations? Obviously financial performance can be, and needs to be, comparable, so that organisations can be valued. Comparing 'outcomes' may be a different story. However, even here, the possibility for metrics that link strategic objectives, outcomes, and probabilities are arguably possible — if not difficult. In both cases, however, the relationship between performance and governance remains oblique.

This leaves the not inconsiderable matter of causation. Identifying a relationship between these factors is one thing; understanding the complex sets of causation that influences them is another. The literature is itself undecided about how this should be approached. The problem of endogenous causation is central to these debates and, based on our data, is arguably a very real consideration. The contribution of this report is to identify some of the factors that need to be measured and built into a model of causation. To date, these factors have received relatively little attention within the governance literature, or been characterised through crude proxy measures. If we accept the Chairs' views — that factors like trust, diversity of worldview and independence of mindset are critical to 'good' governance — then, based on the old adage that what gets measured is what gets done, we need to get serious about measuring these factors and building them into the way our organisations are governed.

It is also clear that governance is a quintessentially human activity and subject to all the imperfections and frailties that engenders. 'Good' governance then provides a pathway to dealing with these limitations.

7.0 | References

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8.0 | Appendices

Appendix 1 — Methodology

The research methodology adopted for this study differed considerably to the approaches that have been used in the past for this topic. As noted in Section 2.0 of this report, the research sought to be more explorative and surface key questions in relation to the causality between factors involved in ‘good’ governance by **specifically addressing the following concerns about the way the topic had been approached in the past:**

- Over emphasis on publically listed companies;
- Extensive use of proxy measures to assess the presence of ‘good’ governance;
- The assumption that all organisational contexts are the same.

It was also important that the research reflect the ‘lived experience’ of directors by collecting their views on the topic. As such, the sample and data collection techniques used were designed to address these points. Therefore the research methodology adopted for this study is a qualitative one, with data collection involving one-on-one interviews with 100 Chairs. Whilst we do not claim statistical validity for the research outcomes, we would argue the approach provides a far richer insight into the characteristics of ‘good’ governance than provided before and a basis from which more targeted quantitative studies may be conducted in the future.

Sampling

As we have used a qualitative approach, the research does not rely on large random samples as is often the case for quantitative studies. However, the characteristics of the sample required careful design in order to address the concerns noted above. Primarily, the sample was designed to maximize the inclusion of diverse views in relation to the target issue.

The breakdown for the sample of 100 interviews is as follows:

- (i) 100 per cent of interviewees were Chairs of organisations (either current, recent or past);
- (ii) The sample was divided into four, with 25 per cent coming from each of the four sectors the AICD represents: Publically Listed, Private, Not For Profit and Public Sector organisations. Due to the fact that many Chairs hold positions in more than one sector, the Chairs were asked to respond to the interview with a given perspective in mind.
- (iii) Each sector was sub-sampled to provide a cross-section in terms of size of organisations represented. This was done as a two-thirds to one-third split in the following ways:
 - Publically Listed: 66 per cent drawn from ASX200 / 33 per cent outside the ASX200
 - Not for Profit: 66 per cent drawn from NFP100 / 33 per cent outside the NFP100
 - Public Sector: Funded by parliamentary budget / not funded by parliamentary budget: Federal & State Government representation
 - Private Unlisted: 66 per cent Large private organisations / 33 per cent mid-market organisations;
- (iv) In addition to the above, we targeted 30 per cent of the total sample to be made up of women where possible. This number is considerably higher than the proportion of female Chairs. However, by oversampling this group, it was hoped that any significant difference in perspective could be picked up.

The interview recruitment process was conducted through the AICD membership, with the above breakdowns achieved in the final sample.

Interview approach

Interviews involved a combination of open-ended questions and narrative capture (Berger and Quinney, 2004). The adoption of narrative capture in the interview was important, as when an individual tells a story of an experience in which they were personally involved they reveal a great deal of information, not only about the situation, but also about themselves and their orientation to the problem being discussed. This includes:

- Salient features of the environment at the time;
- The perceived role of chance and design in the response to the problem;
- The effect of critical incidents during the experience;
- Key stakeholders and the roles they played;
- How they place themselves in the situation, including the level of agency they attribute to themselves and others;
- How they made sense of the situation, their own and others decisions.

This is interesting information in itself and lends itself to critical analysis and comparison. However it is also possible to discern from the embedded attributions the underlying assumptions, beliefs and values held by the narrator. For this study we asked the Chairs to provide an account of two situations drawn from their direct experience:

- A situation where the board made a decision, involving issues of governance, with the result of that decision being organisational performance that either achieved or exceeded expectations;
- A situation where the board made a decision, involving issues of governance, with the result of that decision being organisational performance that failed to meet expectations or performance declined.

In selecting the stories, the Chairs were asked to choose ones in which they were directly involved and took place in their nominated sector. They should also be situations where issues of governance were very much at the centre of the conversation.

Additionally they were asked the following open-ended questions:

1. Are there any particular experiences both prior to and during your board career that have shaped your approach to, or view of, good governance?
2. From the perspective of your current role as the Chair of a NFP/Private sector/Publically listed/Public Sector board, how would you characterise the notion of governance?
 - Do you perceive any key differences between governance in this sector and the others in which you hold directorships?
3. Performance could be described in many different ways depending on the context. What are the key dimensions of performance that matter for your organisation.
4. Given everything we have discussed, what lessons have you drawn regarding the relationship between governance and performance from these experiences?

The interviews were conducted either face to face or over the phone, depending upon the availability/preference of the Chair, and lasted between 45minutes to 1hour and 30minutes in duration. All interviews were recorded and subsequently transcribed verbatim. The resulting transcripts were then subjected to detailed coding in order to enable subsequent analysis.

Coding

The coding process for the transcripts involved capturing the essential meaning of utterances or statements made by the respondents as a set of codes. The depth of coding can vary but for this type of project it is typically at the sentence or paragraph level. The coding can be either bottom-up (no pre-existing frame) or top down (based on a pre-determined set of codes). Both forms of coding were used for this study, depending on the type of analysis being conducted.

Bottom up coding involves the coder generating a code to capture the essential message or meaning of the statement in the transcript. The code will often use the respondents own language or terms (a process known as *invivo* coding). These low level

codes can then be grouped and classified to build a hierarchy of codes which represent increasingly abstracted concepts. Doing this for each respondent then supports analysis of the similarities and differences in what people assume and believe, and how these relate to the issue. Top down coding takes a pre-existing set of constructs as the basis for the coding. These may be, for example, the difference between an agency and stewardship orientation to governance.

These two approaches were used in combination for this study. Bottom up coding supporting theory building (along the lines advocated for Grounded theory Glasser 1978; Strauss and Corbin 1997); while top down coding supported theory testing (i.e. assessing the applicability of the Holling Cycle).

Quantification

Detailed coding supports a level of quantification as the relative frequency with which a code is applied tells us something about the relative importance of the concept or issue signified by that code to the individual. It is possible to standardize the resulting code counts and to then use statistical methods such as factor and cluster analysis to find deeper patterns, both in the relationship between codes at the level of the individual and also across groups of individuals.

Once quantified, datasets can be assembled which introduce other metrics at the level of the individual (age, gender, position, length of tenure, role) or of the institution of which they are a part (corporate, not-for profit, industry sector). This supports analysis of the relationship between these variables and the assumptions, beliefs and values revealed through the narrative analysis.

Theory building

Whilst the method used for this study doesn't constitute a full 'Grounded Theory' approach, it did adopt a number of elements of that technique. To identify a heuristic through which to analyse the interviews, detailed bottom-up coding was conducted. Factor analysis was conducted on the relatively unstructured code frame to identify high-level factors that should be present in a heuristic. A literature review was then conducted

to find a matching explanatory framework that seemed to fit with the key patterns emerging from the transcripts.

In this case, the Holling Cycle was selected as it appeared to fit many of the key patterns represented in the interviews. Similarly Kurtz and Snowden's sense-making framework provided a way of think about the decision-making dynamics presented during the different phases of the cycle.

Theory testing

The data set was then recoded, specifically the sections of the transcript related to the stories, to see if:

- the stories neatly fitted with the Holling Cycle phases; and
- the data provided adequate richness that the sense-making framework could be tested.

Additional analysis

Further coding was conducted to explore key issues in the data set, like for example questions in relation to the effect of gender on attitudes to governance. Code counts were used in order to quantify this data and identify patterns in relation to the Chairs' responses to these questions.

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For further information

t: 1300 739 119

e: research@aicd.com.au

w: companydirectors.com.au